COPY

IN THE

Supreme Court of the United States

OCTOBER TERM, 1960

NO. 245

[illegible] E. SMITH, as Special Administrator of the Estate of Edward S. Birin, Deceased,

Petitioner,

vs.

[illegible] SPERLING, JACK L. WARNER, UNITED STATES [illegible] INC., WARNER BROS. PICTURES, INC., and [illegible] PRESTON, MILTON SPERLING, REA L. WARNER and DORIS WARNER, Executors as Executors of the Estate of HARRY M. WARNER, Deceased,

Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

HERMAN H. LEVY,
750 South Broadway,
Los Angeles 14, California,

MOSS, LYON & DUNN,
210 West Seventh Street,
Los Angeles 14, California,

Counsel for Petitioner

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1960

NO. .....

CHARLES B. SMITH, as Special Administrator of the Estate of Edward S. Birn, Deceased,

Petitioner,

vs.

MILTON SPERLING, JACK L. WARNER, UNITED STATES PICTURES, INC., WARNER BROS. PICTURES, INC., and HERBERT FRESTON, MILTON SPERLING, REA E. WARNER and DORIS WARNER VIDOR AS EXECUTORS OF THE ESTATE OF HARRY M. WARNER, DECEASED,

Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Petitioner prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit, entered in the above entitled case on April 20, 1960.

Citations to Opinions Below.

The opinion of the United States Court of Appeals printed in Appendix hereto, *infra*, page 1, is still unreported.

Jurisdiction.

The judgment of the United States Court of Appeals was entered on April 20, 1960. The jurisdiction of this Court is invoked under 28 U. S. C., Sec. 1254(1).

Questions Presented.

In two causes of action of a derivative suit in a California federal court, petitioner, a shareholder of the publicly-owned Warner corporation claimed that the president and his two brothers *controlled* the company; that they caused the president's son-in-law and an ex-director to become unjustly enriched at the company's expense; that the company would not sue and that petitioner therefore asserted the right of the corporation to have restored to it over a million dollars.

The District Judge (in 1953) realigned the corporation (which had been named a defendant) as a party *plaintiff* and then declined to pass on the merits on the ground that he had no "diversity" jurisdiction of the 1st cause and no "equity" jurisdiction of the 2nd cause. Realignment and dismissal followed a *trial* on the jurisdictional issue and a *finding* made at the conclusion of that trial, to wit: the president and his brothers owned "less than 20%" of the company's stock; they *did not control* the company; that *consequently* the corporation was not alignable as a defendant although it was *admittedly* antagonistic and hostile to the suit. Realignment destroyed diversity. (*Smith v. Sperling*, 117 Fed. Supp. 781.)

The Court of Appeals for the Ninth Circuit affirmed the dismissal of the 1st cause and reversed as to the 2nd cause. (237 F. 2d 817.) This Court granted certiorari on the dismissal of the 1st cause; held the District Court had jurisdiction to hear and determine the merits of the controversy and reversed the dismissal of that cause. (353 U. S. 91-98.)

At a second trial (in 1958, following remand) petitioner (a) *established* that the brothers *did* control the company; (b) presented proof that during some 10 years that the suit was before the lower Courts and in this Court on the jurisdictional question, a series of contracts were made between the Warner corporation and United States

Pictures, Inc. (hereinafter United), a corporation owned by the president's son-in-law which were not only unfair to Warner but which were, moreover, *purposefully, maladministered* in a manner calculated to siphon off and bring about a give-away to the son-in-law of more than a million dollars of Warner money over and above what was rightly due him; and (c) that a Warner ex-director received a $78,000.00 gift in the form of "severance pay," from the corporation when he resigned and joined the son-in-law in the Warner-United venture.

The District Judge thereupon changed his former (1953) finding namely, that the brothers neither controlled nor dominated the company to one that declared they *controlled* and *ran it, i.e.*, they had "effective working control" and "working stock control" and they "actively" directed its "supervision, policies, action and business", *but* they did *not* "DOMINATE" and then *declined to "reach"* and pass on the merits of petitioner's claim that over a million of company money was unlawfully and unfairly diverted to the son-in-law and to the ex-director, on the ground that petitioner had "no standing to sue" thereon in the face of *antagonism* to the suit newly expressed by the Board of Directors *i.e.*, in a "resolution" to that effect passed at the close of the hearing, *10 years after the suit was instituted.*"

The Judge held in effect that to have "standing to sue" in face of this display of antagonism, petitioner had the burden of proving *additionally* that the brothers then and there "DOMINATED" the company, *i.e.*, at the time of the trial, *besides controlling* it. He thereupon dismissed the suit again, in a judgment which provides that the dismissal "shall not operate as an adjudication upon the merits" of the claims which he declined to "reach."

The decisional law of Delaware (the state of the Warner Company's incorporation) accords with the universally accepted corporate rule expressed by this Court in *Rogers*

v. *Hill*, 280 U. S. 582, 591-2, that a corporate majority have "no power to *give away* corporate property against the protest of the minority."

Neither statutory nor decisional law of Delaware nor that of California (the forum state) makes proof of director "domination" of a defendant-controlled company a condition to a shareholder's "standing to sue" derivatively.

California law governing the vindication of wrongs resulting from officers' alleged disloyalty to the company and the courts' duty in such cases to subject challenged dealings between the company and such officers to "rigorous scrutiny" with the "burden" on the accused officers "not only to prove the good faith of the (challenged) transaction but also to show its inherent fairness" to the corporation, has been declared by the Courts of California to correspond with federal law as expressed by this Court in *Pepper v. Litton*, 308 U. S. 295.[1] The decisional law of Delaware is to the same effect.

The Questions Presented Are:

1. Does antagonism manifested by the directors of a publicly and widely owned corporation—"*effective working control*" of which is *established* to be in the hands of the president and his two (vice president) brothers who run the company and who are accused in a derivative suit of siphoning off and *giving away* over a million of company money to a *relative* and to an ex-director—operate to

(a) destroy the shareholder's "*standing to sue*" derivatively, for the restoration of this money by the accused and the relative;

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[1] In *Kennerson v. Burbank Amusement Co.*, 120 Cal. App. 2d 157, 170, *et seq.*, the court quotes at length from *Pepper v. Litton*, *supra*, and concludes by declaring:

"This is the law of California. It was the law before Section 311 of the Civil Code was adopted, and is the law since."

A petition to review was denied by the Supreme Court.

(b) foreclose the court of *power* to grant appropriate relief; and

(c) justify the trial judge to *decline to reach* and to scrutinize the merits of specific challenged transactions that are claimed to be *breaches of trust* and acts *ultra vires*, and to dismiss such a suit leaving the merits thereof undetermined?

2. Does the stockholder so circumstanced have the burden imposed upon him—does his "standing to sue," derivatively, to vindicate such a claimed wrong to his company depend on his ability to prove, affirmatively, that the brothers so accused "DOMINATED" the company *besides controlling it* and *running it?*

3. Did not the District Judge have jurisdiction, *i.e.*, "Equity" jurisdiction to pass on the merits of the claims that he refused to "reach," notwithstanding antagonism by directors of this *defendant-controlled* company, and was not his refusal to exercise the court's jurisdiction the practical equivalent of a *denial of due process?*

Statement.

The foregoing questions were fully and fairly raised in the District Court and, in the Court of Appeals, although the Court's opinion (App. pp. 1-4) is utterly silent thereon.

This was, substantially, the petitioner's case below:

1. That Warner is a major producer and distributor of motion pictures. The company is publicly-owned. United is an "independent" production company. It is owned by a son-in-law (Sperling) and 2 infant grandchildren of Harry Warner who was Warner's president until shortly before his death in 1956. Warner made a contract with United (in 1945) for the production by United and the distribution by Warner of a series of motion pictures (similar to those produced by Warner) the production and distribution costs of which ran into many millions of dollars of

Warner money: From time to time *i.e.*, before as well as during the litigation, the contract had been amended and supplemented.

2. (a) That the terms of these Warner-United contracts were *unfair to Warner*, *i.e.*, so fashioned as to be *unwarrantedly favorable* to the president's son-in-law and unlike *any* production-distribution contract ever made by Warner with any *other* "independent" producer.

(b) That *in addition to being unfair* to Warner, the contracts with United were, moreover, *purposefully maladministered* during this litigation, to Warner's great detriment, *i.e.*, throughout and during the some ten years that it took to settle the District Court's *diversity* jurisdiction (in the two lower courts and in this Court), these agreements were repeatedly breached and violated in a manner *calculated* to bring about and they actually brought about a "give-away" —a virtual gift—to United and Sperling, viz., more than a million of Warner money over what was rightly and justly due or coming, was siphoned off to them. [Ex. 158.]

3. That Warner made a $78,000.00 gift to Joseph Bernhard, a Warner ex-director when he resigned to join Sperling in the Warner-United venture.

4. That the brothers—Harry, Jack and Albert Warner—*ran the company*: they "actively direct its supervision, policies, actions and business" [Admitted R. 112] and that United's contracts with Warner (that plaintiff claimed were maladministered so as to unjustly enrich the son-in-law) were processed minus any *directorial surveillance*. [Admitted R. 198, 213-214, 269, 282-283, 292, 309, 486.]

5. That the brothers *control* the company:

(a) Warner's stock is very widely distributed "among approximately 30,000 shareholders located in

various parts of the world" [Admitted R. 112, 602]; and is listed on the New York Stock Exchange. [Admitted R. 119.]

(b) There has been "no other individual or group among the stockholders or a unit that held any block of stock *comparable* to that held by the brothers during *any time* involved in this case." (Stipulation procured from defendants' counsel and recorded for the *first time* at the 1958 hearing [R. 749-751] following remand by this court in 353 U. S. 91.)

(c) The Warner family—the brothers, their wives, children, sisters and other close relatives—own shares equal to 25% of the outstanding stock. [Disclosed by Warner counsel in Ex. Z, in evidence, pursuant to petitioner's demand for such disclosure. See R. 792-794.]

(d) The brothers occupy a *commanding* position in the selection and make-up and over the behavior of directors; [acknowledged in directors' *depositions*. [R. 195-196, 490, 304-306, 291-292, 283-285.] See for example [R. 490, 304-306, 291-292], directors Friedman and Perkins, company lawyers (salary $80,000 a year, each) concede they would abdicate— "resign" if they were to become *persona non grata* to the Warners and see [R. 195-196], director Carlisle (comptroller), who owns that "Mr. (Harry) Warner and his two brothers in effect *control* . . . whether or not he, Carlisle, shall stay on as Controller or Assistant Treasurer of the company"; that "it is generally Mr. (Harry) Warner that is asked *if he wishes* to make any changes" in the Board; and that "he, (Harry) in effect, *controls* the naming of the Board of Directors. . . ."

Neither Harry Warner nor his brothers *ever faced the Court* in either the 1st or 2nd trials; and there is *no denial* of these statements in the record, by them or any one else.

(e) The brothers had "effective control of the corporation, its *Board of Directors* and *its active management.*" [A *finding* made by the New York Supreme Court in three *recently* (1958) consolidated stockholders' derivative actions (unrelated to this suit) that terminated in a final judgment [Ex. 15⁹] which, based on that finding among others, declared adequate a joint proposal by the defendants (the brothers Warner and the members of the Board) to pay the corporation $100,000. for releasing them from liability on a series of corporate claims predicated on wrongs allegedly committed against the corporation by the brothers *aided by and acting in concert with the directors.*]

Before the second (the 1958) trial closed, a quorum composed of these SAME DIRECTORS met specially in New York City at the suggestion of the District Judge; and they voted not to "lend its sanction" to the maintenance of *this* action. [R. 616, 818-820.]

This meeting—10 *years* after the suit was instituted—was convened upon the judge's veritable insistence (*over petitioner's repeated protests*)[2] that petitioner's case be

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[2] From petitioner's brief below:

"Appellant's counsel protested: The corporation is Warner-controlled. The Warners, whose relatives are being unlawfully enriched, are not shown to be company heads who had once been in a commanding position but who had since ceased to be a controlling influence in the company's business and its policies. To the contrary, the fact of the matter is, they always had, they never stopped having—they never gave up control of this company." [R. 776, 777, 791-793; Deft. Ex. Z.]

Appellant's protests [R. 758-828] were unavailing.

The judge appeared set on the procedure he prescribed and unreceptive moreover, to counsel's repeated observations that under the circumstances, *an opportunity should at least be given appellant to impeach an adverse verdict of this directorial jury.* [R. 773; 775; 778.]

presented forthwith to the Board for *its* verdict thereon. If favorable to petitioner, the judge declared, he would again *realign* Warner as a *plaintiff*. [R. 703.] He gave petitioner's counsel the choice of (travelling to New York and) pleading his case before them in person or doing so in writing. [R. 783.] Counsel took the latter alternative. He wrote them a letter.[3] He sent on additionally, a copy of a brief which he had theretofore submitted to the judge in seeking the *Court's* verdict on whether the son-in-law had not been, in reality, the beneficiary of an extraordinary, *ultra vires* million dollar bonus of Warner money. The package is in evidence as Plaintiff's Exhibit 158.

A "resolution" refusing directorial "sanction" to the maintenance of the suit—their "Business Judgment"—was handed down shortly thereafter and dispatched to the Judge. Along with it came a lawyers' "Report" which featured its authors' opinions and their advice on the law and the facts of petitioner's case, to the general effect that the directors (to whom the "Report" was addressed) would be justified to refuse "sanction" to the suit.[4] The report concludes by advising the directors that theirs is the "prerogative" to say whether the Warners or the son-in-law should or should not be sued.

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[3] The findings depict petitioner as having "elected" to present his case "in writing, to the Board of Directors of Warner Bros. for its action with reference thereto." [Find. XXVII, R. 614, 615].

[4] The following is a typical "advisory" statement:

> "It follows, therefore, that we are of the view that this Board would be justified by the law and the facts if it should, in the exercise of its business discretion, determine that it will not lend its sanction to the position advanced by plaintiff Smith with respect to the loss on Tisa." [Pp. 43-44.]

In the "Tisa" transaction plaintiff claimed that Orloff and Sperling became the beneficiaries of an *ultra vires* bonus and giveaway of over half a million ($535,310.12) of Warner money. This is one of the claims that remain undetermined under the [illegible] provisions of the last paragraph of the District Court's judgment. [R. 619.]

The gentlemen who authored this "Report" and who advocated this "Business Judgment" could not fail to have known that among the recipients of their advice WERE THE SAME persons who, but shortly before (in April of 1958), had been *found* by the New York Supreme Court to be under the *"effective control"* of the very men whose personal fortunes were affected by that "Business Judgment"; they knew that that "Report" was focused on none but the self-same individuals who had recently paid the company $100,000. for a release from liability for their participation with the brothers in conduct allegedly disloyal to the company. The "Report" was prepared and signed by one of the same firm of attorneys that had been retained by the same Warner management and who had appeared for the corporation (which had been joined as a party) in the suits in the New York Supreme Court.

Under the circumstances it is hardly harsh to observe that this "Report" functioned as but so much incidental music to an obviously predestined, cut-and-dried formality, viz.: the drafting of a smartly tailored "resolution" withholding "sanction."

The unfairness to petitioner's cause, implicit and implicit in these Board proceedings were complained of in the Court of Appeals:

> "We submit it was not fair to require appellant to plead with or to require him to set out to convince the Directorate of an *admittedly Warner-controlled company* of the justice of a case against the Warner family; particularly where management had manifested an unalterable, an adamantine resistance to the suit for more than a decade that witnessed argument in the highest court over problems that emerged from this resistance.
>
> "But assuming, without conceding, that it was fair to saddle appellant with that burden, it was nonetheless unfair not to afford him, betimes, the opportunity he sought (R. 773; 777-778) to lay bare the complex of directors' pressures that operated to precondition the result of this excursion from the Courtroom to the Boardroom; and then let the Boardroom judgment become virtually dispositive of appellant's case!
>
> "We submit, moreover, that it was increasingly not equitable with fairness to do all this in the face of facts exhibited in

Among the "Report's" dissembling, however needless, observations—clearly no warrant for *donating* a million to Sperling, *i.e.*, paying United that much more than was justly due by the terms of the Warner-United contracts—was one to the effect that *after all* the contract was lucrative for Warner, *i.e.*, the Warner Company did not lose—it made money in the Warner-United ventures; and another, that the authors consider it "*unlikely*" that "a court will find the (petitioner's) claim to be meritorious." (pp. 58-59.)

The document is *singularly muted on*—it contains not the faintest adversion to, such relevancies as control in the Warners or that corporate give-aways are forbidden.

The resolution and the "Report"—the latter admittedly grounded on hearsay[6] were received in evidence.

The District Judge thereupon declined to "reach" and to scrutinize the merits of the claim that this was virtually a huge gift to a presidential relative. He held, in effect, that that "Business Judgment," registering as it did the *corporation's* refusal to "sanction" the suit, deprived petitioner of *his* "standing to sue" thereon [R. 614, 820]; for, notwithstanding petitioner had *never established* "effective working control" of the corporation (past and present)

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the judgment roll in the New York stockholders' suit (Ex. 159) which, coupled with the fact that these directors turned back $100,000.00 to the treasury (or the Warners did, for all of them), pointed to say the least, if it did not bespeak, the existence of a *close*, if not dubious *relationship* between these Board members and the Warners" (citing *Heaton v. City Bank*, 312 U. S. 262, 265-266).

[6] From page 4 of the Report:

"At the same time we have recognized that we are not confined to the California Record, and we have freely taken into account matters of general knowledge in the motion picture industry, as well as *information given to us by Warner executives responsive to questions directed to them at the California Records*. We have also conducted our own research on such questions of law as appeared pertinent to our assignment."

[R. 825-826] in the brothers, he had nevertheless, still not shown the directors to have been "DOMINATED" [R. 826] when they handed down this "Business Judgment." [R. 824-826; 618.]

The foregoing proceedings *i.e.*, the meeting of the quorum, the "Report," the "Resolution" refusing "sanction" and the ensuing "Business Judgment" became the subjects of Finding XXVII [R. 614-617] and Conclusion V [R. 618-619]; and the predicate for a judgment which dismisses petitioner's suit and adjudges, in effect, that however meritorious his claim, petitioner had no "standing to sue" and was not to be heard thereon, viz.:

> "That this judgment of dismissal shall not operate as an adjudication upon the merits as to any claims arising from alleged non-performance or breach of any contract, or amendment or supplement thereto, between Warner Bros. Pictures Inc., and United States Pictures, Inc. nor as to any claim arising from the payment by Warner Bros. Pictures, Inc. of $78,000 as 'severance pay' to Joseph Bernhard." [Final par. of the judgment R. 619.]

The events that are narrated above; and the proceedings that led—after a long 10-year battle for the right to be heard—to but *sweeping under the rug*, so to speak, claims which, were they to have been "reached" and, *after appropriate scrutiny by the trial judge (Pepper v. Litton; Rogers v. Hill, supra)*, found to be well grounded, would have warranted no other conclusion than that the Warner corporation had been despoiled to the tune of more than a million dollars; these proceedings were defended by the respondents in the Court of Appeals as being in conformity with California law and what a California state court would have been obliged to do, on the authority of the following statement of the "Business Judgment Rule" in *Findley v. Garrett*, 109 Cal. App. 2d 100:

"The power to manage the affairs of a corporation is vested in the board of directors." (Citation.) Where a board of directors in refusing to commence an action to redress an alleged wrong against a corporation, acts in good faith *within the scope of its discretionary power* and reasonably believes its refusal to commence the action is good business judgment in the best interests of the corporation, a stockholder is not authorized to interfere with *such discretion* by commencing the action." (Emphasis ours.)

To this contention petitioner replied:

1. Petitioner directed the attention of the Court of Appeals to Section 183 of the Restatement, Conflict of Laws as follows:

"The right of a shareholder to object to conduct occurring in the operation of the corporate enterprise is determined by the law of the *state of incorporation.*" (See *Perlman v. Feldman*, 219 F. 2d 173, at 175, citing *Rogers v. Guaranty Trust, infra*, 288 U. S. 123, 130.)

2. The Delaware Courts, citing *Rogers v. Hill, supra*, have consistently adhered to the "accepted rule that majority stockholders have *no power* to give away corporate property against the protest of the minority."[7]

Frankel v. Donovan, 120 A. 2d 311, 316;

Gottlieb v. Heyden Chemical, Infra.

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[7] Judge Mayer in *Bassick v. Aetna Ins. Co.*, 24 Del. 974, put it in these words:

"It is to the ultimate interest of business and the protection and prosecution of large enterprises that the investing public must feel confident that a just appeal to the courts will not be unheeded, and that the courts will not permit their property to be disposed of *under circumstances which amount to a gift*, and those dealing with corporations cannot rely upon the proposition that a board of directors has the power, in law, to authorize a gift. Doubtless a natural person, in the absence of fraud or duress, *can give away* his property. *Not so with the directors of a corporation as to corporate property.*"

3. The quoted statement in *Findley, supra*, it should be noted, was made on a factual background essentially different from that in the instant case: Replying to shareholder Findley's demand, the Board advised him, in effect that in view of the breadth and depth of his accusations, it was justified in imposing as a condition to the *commencement* by the corporation of what promised *to become* a costly, bitter legal battle, that the stockholder *presently share with the Board* such evidence of alleged skullduggery as he possessed. This, Findley disdained to do. His response was to himself commence a derivative suit. In the instant case, the situation facing the board was just the opposite: it was to a 10 year old bitterly fought litigation that had just *come to a close* with all the evidence in, awaiting only the court's verdict thereon, to which the board proceeded to "resolve" not to "lend its sanction."

In distinguishing *Findley* from the case at bar, petitioner urged upon the Court of Appeals that *wherein* in that case,

> ". . . it was the *determined*, if not capricious, *refusal* by Findley to descend from generalities to particulars—*to specify* and *reasonably identify* the *particular transactions* which he charged were breaches of trust or deliberate frauds, *after repeated requests that he do so*, from a directorate *that avowed its readiness to vindicate such wrongs*—which largely motivated the decision *in that case*; witness the lengthy correspondence between the attorney for the suing stockholder and the directorate, ordered printed *in full* as an *appendix* to the court's published opinion. (109 Cal. App. 2d at pp. 180-183.)" (From p. 4 of Petitioner's Reply Brief.)

in the case *at bar*, petitioner

> ". . . isolated, *identified* and adduced detailed *proof* of over a million dollars in give-away overpayments

to a son-in-law of the most influential figure in a controlled corporation—'a misuse and waste of the money of the corporation' (Rogers v. Hill, supra) a series of breaches of trust emanating from maladministration of these Warner-United contracts; exhibited (*after* remand by this Court and the Supreme Court) a *controlled corporation*—not only controlled 'effectively' by the Warner family but 'run' by the brothers, who *never faced* the Court, with a directorate of 'biddable' men (Sanborn J. in Wheeler v. Abilene Natl. Bank Bldg. Co. 150 Fed. Supp. at 393-394, cited in appellants' opening brief, p. 26) beholden to the Warners (Greene v. Allen, 114 A. 2d 916, 920-922, similarly cited at p. 45), nearly all of whom the District Judge never saw; who *concededly* (R. 587), would never have brought this suit against the Warner family if appellant or any group of stockholders had demanded (in 1948) that they do so; a directorate composed of men who (appellees' briefs do not dispute it) paid the company a lot of money for a release from personal liability for wrongs against the company allegedly committed by them in concert with the Warners who were found, at the close of the hearing *after* remand by this Court *and the Supreme Court* (*and not before*) to have 'effective working control' of the company." (*id.* p. 5.)

4. Petitioner likened the situation in the instant case to the *factual* situation that obtained in *Bayer v. Beran*, 49 N. Y. S. 2d 2, in which the court said:

> "To encourage freedom of action on the part of directors, or to put it another way, to discourage interference with the exercise of their free and independent judgment there has grown up what is known as 'The Business Judgment Rule'. . . . (id. p. 6.)
>
> "*The 'Business Judgment Rule,' however yields to the rule of undivided loyalty.* This great rule of law

is designed 'to *avoid* the *possibility* of fraud and to *avoid the temptation* of self-interest' (citing cases). . . . 'Included within its scope is every situation in which a trustee chooses to deal with another in such close relation with the trustee that possible advantage to such other person might influence, *consciously* or *unconsciously*, the judgment of the trustee.' (citing cases). . . . *Such personal transactions* of *directors with their corporations*, such transactions as may *tend* to produce a conflict between self-interest and fiduciary obligations, are, when challenged, *examined with the most scrupulous care*, and if there is any evidence of improvidence or oppression, *any indication* of unfairness or *undue advantage*, the transactions will be voided." (*id.* at pp. 6-7.) . . .

Petitioner proceeded to point out that the rationale in *Bayer, supra*, underlies the reasoning of the California Supreme Court in *Wickersham v. Crittenden*, 93 Cal. 17, 28-29; in *Western States v. Lockwood*, 166 Cal. 185, 190, 191, 193; and in *Keimerson v. Burbank, supra*; and that the California courts' approach to judgment in these cases as that of the New York Court in *Bayer, supra*, parallels that viewed as fitting and proper by this Court in *Rogers v. Hill, supra*, and in *Pepper v. Litton, supra*.

Reasons for Granting the Writ.

I.

The courts below have declared on an important question of law—one of profound concern to some twelve million shareholders of publicly owned corporations—in a manner essentially contrary to and in conflict with this Court's decisions.

They ruled: (a) that petitioner, a minority shareholder—who, claiming spoliation and seeking to compel restitution of substantial sums of company money claimed to have been purposefully and unlawfully siphoned off and

given away to favored relatives of accused executives that control and run his company—*has no "standing to sue"* derivatively in a California federal court because the directors of this defendant-controlled company took occasion to notify the trial judge that they voted not to "lend their sanction" to his suit; (b) that, because petitioner did not furnish proof of actual "DOMINATION" of the directors by the accused executives, the trial judge, without stopping to inquire whether these were bonus payments and colorable, may decline to "reach" the merits; and (c) that, without scrutinizing the specific transactions complained of as being acts *ultra vires* as well as serious breaches of trust, the judge may dismiss the suit and in the judgment of dismissal proclaim that the merits of such "unreached" claims consequently remain undetermined.

In *United States v. Union Pacific Railroad*, 225 U. S. 61, 95-96, where Union owned 46% of Southern Pacific stock, this court observed that, while in small companies holdings of less than a majority of the stock do not afford the holders control, in large corporations where the stock is widely distributed, a "compact united ownership" of a substantial block but less than a majority is "ample to control the operations of the corporation" and that such stock ownership actually gives the holders "a dominating interest" in the company.

The case differs from the instant case (on this phase) only in the fact that in Union, Mr. Harriman (at p. 96) "frankly" *admitted to a reality* which the brothers Warner *did not come to court to deny*, namely that "domination" is but the silent partner of "control."

In *North American v. Securities Exchange Commission*, 327 U. S. 686, 693, the court said of "domination" in corporate life that, while domination is readily observable in and equatable with "arbitrary imposition of command," it would be ignoring reality not to recognize that

domination springs as readily from "subtle or unexercised power," and that

> "Historical ties and associations combined with strategic holdings of stock can on occasion serve as a potent substitute for the more obvious modes of control."

In *Koster v. Lumbermans*, 330 U. S. 518, 522, the Court held the shareholder's derivative suit to be an invention of equity to "redress breaches of fiduciary duty by corporation managers." It said that "Usually the wrongdoing officers also possess the *control* which *enables* them to suppress" corporate action to remedy the wrong; that "equity therefore *traditionally* entertains" the derivative suit in the right of the company when it refuses to do so.

It is this *ability* to suppress corporate action—this *capability* born of "strategic holdings of stock" that has *traditionally* moved equity to "entertain" the stockholders' plea and so thwart impending injustice to an otherwise helpless minority.

In *Rogers v. Hill*, 289 U. S. 582, a derivative suit, where the shareholders' challenge was directed to his company's paying president Hill a million more than was justly due him, the court ruled (pp. 591-592) that the *trial judge* was "required" to determine "whether and to what extent," large colorable bonus payments to the president "constitute misuse and waste of the money of the corporation"; and, that a corporate majority has *no power* to "give away corporate property against the protest of the minority."

In *Pepper v. Litton*, 308 U. S. 295, 306, the court ruled that dealings between the corporation and its official family *i.e.*, its officers, directors, etc., that are challenged as unlawful, disloyal or unfair to the corporation will be "subjected to rigorous scrutiny" by the court in which such dealings are complained of, in a process in which the of-

ficer or director involved is made to *shoulder the burden* of proving not only the "good faith of the transaction but also to show its *inherent fairness* from the viewpoint of the corporation and those interested therein."

In *Rogers v. Guarantee Trust*, 288 U. S. 123, 130, the Court held that the officer's or director's fiduciary obligation must in the first instance be measured by the law of the state of incorporation of the company, in the case at bar, the law of Delaware.

In *Bovay v. Byllesby*, 27 Del. Ch. 381, 383, 38 A. 2d 808, the Supreme Court of Delaware, in holding that the state's Statute of Limitations was not available to directors who were charged with breaches of trust, concluded an exhaustive opinion with the following statement which we urge is apposite:

> "Sound public policy requires the acts of corporate officers and directors *in dealing with the corporation* to be viewed with a reasonable strictness. Where suit is brought in equity to compel them to account for loss or damage resulting to the corporation through passive neglect of duty, without more, the argument that they ought not to be deprived of the benefit of the statute of limitations is not without weight; but where they are required to answer for wrongful acts of commission by which *they have enriched* themselves to the injury of the corporation, a court of conscience will not regard such acts as *mere torts*, but as *serious breaches of trust*, and will point the moral and make clear the principle that corporate officers and directors, while not in strictness trustees, will, in such case,

---

In *Feldman v. Feldman*, 210 F. 2d 173, at 175, the Court, citing *Rogers v. Guarantee*, *supra*, says:

> "Both as director and as dominant stockholder, Feldman stood in a fiduciary relation to the corporation and to the minority stockholders as beneficiaries thereof (citing *Pepper v. Litton*). His fiduciary obligation was not to be measured by the law of Indiana, *the state of mere situs*,

be treated as though they were in fact trustees of an express and subsisting trust, and without the protection of the statute of limitations, especially where insolvency of the corporation is the result of their wrongdoing."

In *Gottlieb v. Heyden Chemical Corporation*, 33 Del. Ch. 82, 87, 90 A. 2d 660, a derivative suit in which the challenge was to a "Restricted Stock Option Plan" (approved by the Board *and ratified by a majority of the stockholders*) that awarded stock options to six of the Board members, the same Court took occasion to say:

> "Human nature being what it is, the law, in its wisdom, does not presume that directors will be competent judges of the fair treatment of their company where fairness must be at their own personal expense. In such a situation the burden is upon the directors to prove not only that the transaction was in good faith, but also that its intrinsic fairness will withstand the most searching and objective analysis." Fletcher, Cyclopedia of Corporation Laws, Vol. 3, Sec. 921. Loft, Inc. v. Guth, 23 Del. Ch. 384, 418 A. 2d. The stipulation here settled that the board believed that all things considered, the corporation would derive benefits from the plan, but the necessity for the directors to prove that the bargain had in fact been at least as favorable to the corporation as they would have required if the deal had been made *with strangers* was wholly *left out of account*.
>
> And directors may be mistaken as to the *law* of a transaction. When a board acts under a misconception of the law on a vital point, *judicial review is in order without there being any question of bad faith*. Honest directors conceivably might give away to their associates in the enterprise substantial amounts of a corporation's property in the belief that the gift would produce such gratitude that ultimately the corpo-

tion's generosity would be more than repaid. There would be nothing immoral or dishonest about such an action, *but it would not be legally sound.*"

"Certainly gifts to themselves (management) or *to their business associates* will not avail against the vote of any qualified objector. Since a gift may be in part only, a totally inadequate consideration, of course, invokes the same principle as the absence of any at all."

Rogers v. Hill, 289 U. S. 582, 53 S. Ct. 731, 77 L. Ed. 385.

II.

Clearly the questions presented are of importance since affected by them are the rights of some twelve million citizens who have invested in shares of publicly owned American companies substantial portions of their savings,[2] to obtain relief from corporation practices which are evil,[3] practices which water down and dilute the rightful share in their companies' profits or millions of proxy signing,[4] naive, uninformed and trusting shareholders.

In *Cohen v. Beneficial Loan Corp.* 337 U. S. 541, the court in upholding the constitutionality of a New Jersey statute designed to shield corporations against *groundless* claims of betrayal by corporate trustees, took occasion to note that with the expansion of corporate enterprise,

"management became vested with almost uncontrolled discretion in handling other people's money": money coming into their hands "from numerous and scattered" small shareholders; that management was not subject "to an effective accountability"; that shareholders "in the face of the gravest abuses were singularly impotent in obtaining redress of abuses of trust." The court went on to say (p. 548):

> "Equity came to the relief of the stockholder, who had no standing to bring civil action at law against faithless directors and managers. Equity, however, *allowed him to step into the corporation's shoes* and to seek in its right the restitution he could not demand in his own. It required him first to demand that the corporation vindicate its own rights, but when, as was usual, those who perpetrated the wrongs also were able to obstruct any remedy, equity would hear *and adjudge* the corporation's cause through its stockholder with the corporation as a defendant, albeit a rather nominal one. This remedy, *born of stockholder helplessness*, was long the *chief regulator* of corporate management and has afforded no small incentive to avoid at least *grosser forms of betrayal* of stockholders' interests. It is argued, and not without reason, that *without it there would be little practical check on such abuses.*"

We urge that these words will be robbed of their true meaning if so interpreted as will render a shareholder's "standing to sue" derivatively men who have "effective working control" of his corporation and whom he accuses of unjustly enriching their relatives, dependent on whether he is able to demonstrate additionally something so essentially subjective as the "dominated" state of mind of directors of such a *controlled* company who vote against "lending their sanction" to his suit; particularly when among those so voting (as in this case) are directors who

are on record as admitting they would not be there to vote if they were to become *persona non grata* to the accused.

With deference to the Courts below, we urge that their holdings here are hardly in harmony with this Court's recent observations:

> "It has been the whole course of our law to break down the barriers against calling corporations to account in all states where they may do wrong in doing business."

Mr. Justice Reed in *Koster v. Lumbermen's Mutual*, 330 U. S. 518 at 538.

> "The whole trend of recent Congressional legislation has been to protect corporate stock and security holders. See, *e.g.*, Securities Act, 1933. But this legislation was not intended as a complete substitute for the antidote provided by stockholders' suits for the dangers inherent in the modern development of frequent conflicts of interest between corporate owners and corporate managers."

Mr. Justice Black in the same case at page 532.

Conclusion.

For the foregoing reasons, this petition for a Writ of Certiorari should be granted.

Respectfully submitted,

HERMAN H. HENRY; and
MOSS, LYON & DUNN,
Counsel for Petitioner.

APPENDIX

Opinion in the United States Court of Appeals for the Ninth Circuit.

United States Court of Appeals for the Ninth Circuit.

Charles B. Smith, as Special Administrator of the Estate of Edward S. Birn, Deceased; Appellant, vs. Milton Sperling, *et al.*, Appellees; No. 16,387.

April 20, 1960.

Appeal from the United States District Court for the Southern District of California, Central Division.

Before: Chambers, Magruder and Jertberg, Circuit Judges.

PER CURIAM.

This case was up on appeal previously. Smith v. Sperling, 237 F. 2d 317 (C. A. 9th, 1956), rev'd 354 U. S. 91 (1957).

It started by the filing on December 15, 1948, of a typical minority stockholder's derivative suit brought by the plaintiff, a citizen of New York, against Warner Bros. Pictures, Inc., and United States Pictures, Inc., both Delaware corporations, and against certain named individuals, Harry M. Warner, Jack L. Warner, and Milton Sperling, all citizens of California. Sperling was the son-in-law of Harry M. Warner. Originally the complaint contained three causes of action, but the third suit was dismissed without prejudice several years ago, and we are now concerned only with the first and second causes of action.

The first, brought against all the defendants, charged that a certain contract for the production of motion pictures, and subsequent modifications thereof, had been made improperly by Warner Bros. Pictures, Inc., with United States Pictures, Inc., as a result of domination of the former corporation by the stock control of the Warner brothers, for the purpose of enriching United States Pic-

tures, Inc., and its president, Milton Sperling, at the expense of Warner Bros. Pictures, Inc. The relief sought was the cancellation of the contract. This relief has now become moot with the expiration of the contract, and what the minority stockholder is presently seeking is a financial reimbursement to Warner Bros. Pictures, Inc., for errors or misrepresentation of the contract during the time it was being administered.

After a lengthy hearing, the district court found as a fact that though the individual defendants, the Warner brothers, had sufficient stock ownership to control the election of the directors of Warner Bros. Pictures, Inc., such directors were not, as alleged in the complaint, "dominated" by them, but had approved the contract in good faith and in the exercise of their independent business judgment as being a sound business arrangement for the best present and future interest of Warner Bros. Pictures, Inc. Therefore the district court thought that, so far as the first cause of action was concerned, Warner Bros. Pictures, Inc., should be realigned as a party plaintiff, and as thus realigned there would be no diversity of citizenship. Hence the district court entered an order dismissing the first cause of action for lack of jurisdiction. Smith v. Sperling, 117 F. Supp. 781 (S. D. Cal. 1953).

The second cause of action was different in that United States Pictures, Inc., was not named as a defendant, and the complaint charged mismanagement of Warner Bros. Pictures, Inc., by the individual defendants as officers and directors of the corporation, all to the large pecuniary loss of the corporation. This cause of action the district court also dismissed, but on the merits for lack of equity.

On appeal this court thought the district court was right as to the first cause of action, but reversed its action as to the second and remanded the case to the district court for trial on the merits of the second cause of action.

237 F. 2d 317. Upon certiorari issued by the Supreme Court, that Court held, as to the first, that whether or not the directors of Warner Bros. Pictures, Inc., were "dominated" by Messrs. Warner, as to which the Supreme Court of course did not undertake to decide, nevertheless if the corporation through its board of directors refused to bring a suit, even though the directors were acting independently and in good faith, it was improper for the district court to realign the corporation as a party plaintiff and thus to defeat the federal jurisdiction. Accordingly, in reversing our determination, the Supreme Court remanded the case to the district court for trial of the first cause of action on the merits. 354 U. S. 91.

Because there was some overlapping of the jurisdictional issues as conceived by the district court and the issues on the merits, the earlier trial in the district court was very extensive. It was stipulated that all the evidence taken at the first trial should be considered on the merits.

The district court, pursuant to the remand, resumed its hearings and much further evidence was offered and received. Appellant offers no objection that any evidence on his behalf was improperly excluded. Finally, on December 17, 1958, a new set of findings was issued by the district court, and judgment was entered on the basis of these findings dismissing both the first and the second causes of action on the merits. The judgment now on appeal specifically contained a clause stating that:

> "'[T]his judgment of dismissal shall not operate as an adjudication upon the merits as to any claims arising from alleged non-performance or breach of any contract, or amendment or supplement thereto, between Warner Bros. Pictures, Inc., and United States Pictures, Inc.; nor as to any claim arising from the payment by Warner Bros. Pictures, Inc., of $78,000 as 'severance pay' to Joseph Bernhard."

On the findings of fact by the district court, which seem to us to be adequately suported by the evidence, we think that the district court's judgment of dismissal was inevitable and correct. There is no doubt that the production contract with United States Pictures, Inc., proved in operation to be very lucrative to Warner Bros. Pictures, Inc. Under the contract, Warner Bros. Pictures, Inc., received and handled all the gross receipts from the exploitation of the pictures and allocated the same in accordance with its terms. There was testimony by an employee of Price, Waterhouse & Company, independent auditors for both corporations, that the accounting practices of each were in accordance with the practices acceptable in the industry. Appellant does not claim that defendant, United States Pictures, Inc., diverted to improper uses any of the gross receipts. The trial judge found, as he had in substance found previously, as follows:

> "The Court finds that the said Board of Directors acted in good faith, without fraud, coercion or domination of any person or persons whatsoever; that in considering and passing upon said matters said Board and the members thereof intended to and did act in the interest of Warner Bros. and exercised its and their independent business judgment; and that its and their decision, as above set forth, was the exercise by it and them of such independent business judgment; that such matters were matters properly before said Board and properly the subject of the exercise by it of its said independent business judgment."

A judgment will be entered affirming the judgment of the District Court.

(Endorsed) Per Curiam Opinion Filed April 20, 1960.

FRANK H. SCHMID, *Clerk*.

ILE COPY.

FILED
AUG 11 1960
JAMES R. BROWNING, Clerk

IN THE

Supreme Court of the United States

OCTOBER TERM, 1960

No. 245.

CHARLES B. SMITH, as Special Administrator of the Estate of Edward S. Birin, Deceased,

Petitioner,

vs.

MILTON SPERLING, HARRY M. WARNER, JACK L. WARNER, UNITED STATES PICTURES, INC. and WARNER BROS. PICTURES, INC.,

Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Brief of Respondents United States Pictures, Inc. and Milton Sperling in Opposition to Petition for Writ of Certiorari.

OLIVER E. SCHWAB,
HAROLD S. KANT,
141 El Camino Drive,
Beverly Hills, California,
Counsel for Respondents, United States Pictures, Inc. and Milton Sperling.

Parker & Son, Inc., Law Printers, Los Angeles. Phone MA. 6-9171.

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IN THE

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CHARLES B. SMITH, as Special Administrator of the Estate of Edward S. Birin, Deceased,

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Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Brief of Respondents United States Pictures, Inc. and Milton Sperling in Opposition to Petition for Writ of Certiorari.

In setting forth the Questions alleged to be presented and in his Statement of the Case, Petitioner has intermingled, in what we believe to be a misleading manner, certain claims decided adversely to Petitioner in the District Court *and not contested in* [*appealed to*] *the Court of Appeals*, with other distinct claims also decided adversely to Petitioner in the District Court and which were appealed, unsuccessfully, to the Court of Appeals. Because of this confusion and because we

take serious issue with Petitioner's presentation of the facts, these Respondents respectfully deem it necessary to set forth their own Statement of the Facts and Questions Presented."

Questions Presented.

It is respectfully submitted that there are no questions presented of sufficient dignity or magnitude to justify review by this Honorable Court. The sole question presented is one which, because it presents no federal issues, this court has by tradition and policy deferred to the determination of the proper Court of Appeals, to wit:

> In this shareholder's derivative action, did the Court of Appeals err in affirming the District Court's determination under relevant *state* law that the "Business Judgment Rule" governed, viz. that claims based on certain alleged accounting irregularities could not be maintained where the directors of the corporation decided, in the exercise of their independent business judgment, in good faith, and without fraud or domination of any person or persons whatsoever, that it was not in the best interest of the corporation to prosecute such claims?

Statement of the Case.

A. General History of the Case.

This is a stockholders' derivative suit which Petitioner brought for the alleged benefit of Respondent Warner Bros. Pictures, Inc., a corporation ("Warner Bros."). The action was commenced in 1948. Petitioner's alleged cause of action then was that a contract between Warner Bros. and Respondent United States Pictures, Inc. ("United"), for the production

distribution of a series of motion pictures, had been wrongfully entered into for the purpose of unjust enrichment of United and Respondent Milton Sperling ("Sperling"), at the expense of Warner Bros. After a period of trial in 1953, the District Court realigned the parties in the first cause of action and found that diversity jurisdiction was absent. It dismissed the first cause of action for that reason, and dismissed the second cause of action for lack of equity as the parties then stood. The third cause of action had previously been dismissed pursuant to stipulation.

On appeal to the United States Court of Appeals for the Ninth Circuit, that Court affirmed the District Court's judgment on the first cause of action, but remanded the case to the District Court for further proceedings on the second cause of action.

This Honorable Court granted certiorari and, by a divided Court, held that diversity jurisdiction existed on the first cause of action.

The case came on for further trial of the *non federal* issues in the District Court in 1958, at which time, by stipulation, the testimony and documentary evidence submitted in the 1953 trial was deemed part of the record on the merits for the 1958 trial. The 1958 trial plus the 1953 trial thereof, therefore, involved an aggregate of approximately 25 days of hearing, and hundreds of exhibits introduced by Petitioner in addition to a goodly number of Respondents.

In December, 1958, the District Court handed down its decision, ruling on the *merits* against Petitioner on the first cause of action as contained in its complaint in 1958. However, in 1958, the District Court had admitted all testimony presented by Petitioner at the

actions between Warner Bros. and United right down to trial; and the District Court ruled that, under Rule 54(c), Federal Rules of Civil Procedure, the Court must consider all such evidence introduced at the 1958 trial as though the complaint had been amended to include allegations of such evidence. Based on this 1958 evidence, Petitioner for the first time advanced several completely new postverted claims, all inmisically of an accounting nature, involving alleged misinterpretations in the operation of the contract which Petitioner claimed were detrimental to Warner Bros. As to these new accounting claims, the District Court decided that, under the substantive law governing the case, the "Business Judgment Rule" applied; that the Board of Directors of Warner Bros. had, in the honest and free exercise of its business judgment, determined that it was not in the best interests of Warner Bros. to maintain such claims. Accordingly, the District Court ruled against Petitioner on such new claims. Under the Business Judgment Rule, the District Court further ruled that such judgment on these claims would not be *res adjudicata* in any case that neither United nor Warner would subsequently be foreclosed from asserting any accounting claims against the other during or after the remaining term of the agreement between Warner Bros. and United.

On appeal to the United States Court of Appeals for the Ninth Circuit, the decision of the District Court was unanimously affirmed in all respects.

B. Issue Before This Court.

It is clear that the Petitioner's sole objective in the entire controversy as it was presented before this Court for ten years, from the filing of the complaint

in December, 1948, until the commencement of the second hearing in April 1958 to test the validity of the basic production distribution agreement entered into between Warner Bros. and United in 1945 and the various supplemental and amendatory agreements thereto.

At the close of trial in 1958, the District Court adjudged, *on the merits* that all such contracts, amendments, and agreements entered into and introduced in evidence up to the close of trial in 1958 were not only "*made and entered into in good faith and without fraud*" but "*were fair and reasonable*" [Find. XXV, R. 612-613].

Petitioner, however, in the Court of Appeals and in his Petition for Certiorari, sought to convey the impression that the District Court had decided the entire case on the Business Judgment Rule and, accordingly, that the District Court had entirely deprived the Petitioner of a decision on the *merits*".

Since Petitioner had, quite apparently by invention, cast the issue on appeal as one of Business Judgment Rule only, his appeal to Court of Appeals raised no issue as to the propriety of the findings, conclusion and judgment of the District Court on the broad and sweeping issues disposed of on the merits. Moreover, no such issue is raised here. No matter, the record created, for the most part by Petitioner, throughout 25 days of trial and, hundreds of exhibits, overwhelmingly supports the District Court's findings, conclusions and judgment on the merits, as affirmed by the Court of Appeals, and they would in any event be beyond any realistic challenge.

Accordingly, the single question is whether the District Court, in full view of the substantive state law of

plicable to the accounting issues newly raised in 1958, properly applied the Business Judgment Rule.

For purposes of clarity, however, a concise statement of all the basic facts is presented herewith.

C. The Facts.

Petitioner's complaint herein, and Petitioner's position throughout ten years of litigation, were all one heinous charge that Sperling, because he was the son-in-law of one of the four brothers who had founded Warner Bros., had allegedly been given a contract with Warner Bros. "illegally, wrongfully and in bad faith," and that the directors of Warner Bros. misappropriated assets of Warner Bros. in order to enrich Sperling; that this injury to Warner Bros. was done through conspiracy with and domination by H. M. Warner, Jack Warner and Albert Warner—men whose lifelong careers had been devoted to the development of the motion picture industry, and, in particular, to the successful development of Warner Bros.

The facts are completely to the contrary, and are virtually without contradiction in the record.

The Original Contract.

Production-distribution agreements with independent producing corporations have been common in the motion picture industry. Warner Bros. has entered into many of them, both before and after the Warner-Unity agreement in 1945. (See Defs. Exs. V-1 to V-15.)

The original contract speaks for itself; it has been set out on the record from the beginning (Pltf. Ex. 1). The Delaware Court has examined the contract and

found it "fair and reasonable" [Find. XXV, R. 612-613].

The overall benefits to Warner Bros. from the contract and the additions and supplements thereto have been tremendous. The record shows without contradiction [Defts. Ex. Q] that Warner Bros. actually received to August 31, 1957, from the first ten pictures produced by United under the Warner-United agreement total benefits of $13,001,504. These include Warner Bros. distribution fees, Warner Bros. overhead received, Warner Bros. share of profits and other items on the ten pictures. The total estimated benefits to Warner Bros. from the ten pictures, from ultimate final world gross, is calculated at $14,955,000. [Defts. Ex. R.]

> "There is no doubt that the production contract with United States Pictures, Inc. proved its operation to be very lucrative to Warner Bros. Pictures, Inc." [Opinion of the Court of Appeals, Appendix B.]

The Warner Bros. Board.

The Warner Bros. Board of Directors which passed upon the original contract consisted of 11 members (one vacancy existed which was filled in November 1945); three of them were Harry, Jack and Albert Warner. [R. 27.]

Neither Harry Warner nor Jack Warner attended or participated in the meeting of September 25, 1945 at which the contract drawn was first mentioned [R. 503-504], nor that of September 28, 1945 at which it was approved. At the meeting of September 28, 1945 director Stanley Fridman explained to the Board in detail the terms of the contract [R. 453-460]. The

contract was unanimously approved [Pltf. Ex. 18, R. 605-606].

Testimony of every one of these directors is in the record. Of the 7 directors (other than Harry, Jack and Albert Warner), Petitioner took the depositions of five; all of such depositions were introduced in evidence and most all of such depositions were read into the record by Petitioner [Carlise, Pltf. Ex. 113, R. 179-196; Catchings, Pltf. Ex. 116, R. 243-269; Guggenheimer, Pltf. Ex. 117, R. 270-285; Perkins, Pltf. Ex. 119, R. 293-308; Wolf, Ex. 118, R. 285-292]. Petitioner requested Director Stanleigh Friedman to testify at the trial and he did so [R. 443 *et seq.*]. Director Schneider also testified [R. 507 *et seq.*].

In 1953, the District Court found as follows:

> "That the Board of Directors of Warner Bros. Pictures, Inc. is composed of eleven men of whom the defendants Harry M. Warner, Jack L. Warner and their brother, Albert Warner, are but three; that the contract in controversy was made and entered into in good faith and without fraud; that in approving and authorizing the contract, the officers and Board of Directors acted in good faith and exercised their independent business judgment." [Find. IV, R. 74-75].

The finding that the directors were not dominated by Harry Warner, or his brothers, and that they acted in good faith, was affirmed by the Court of Appeals in the first appeal and such finding was not affected by the reversing decision of this Honorable Court. No new evidence with respect to domination or the good faith

that directorate has been introduced since this case last appeared in this Court. Moreover, the District Court, at the 1958 hearing, made a similar finding to the 1953 finding quoted above [Find. II, R. 602], and such finding was affirmed again by the Court of Appeals [Appendix B].

The 1947 Supplemental and Amendatory Agreement.

In 1947, after three pictures had been produced under the original contract, Warner Bros. and United entered into a supplemental and amendatory agreement [Pltf. Ex. 4]. Warner Bros. desired more pictures; the 1947 amendment established a new group of pictures called "additional pictures," and provided for the production of four such "additional pictures" [Pltf. Ex. 4].

The District Court examined this contract in 1953. No new evidence in support of plaintiff's attack on the 1947 contract was introduced at the 1958 trial.

The District Court has found the 1947 contract fair and reasonable [Find. XXV, R. 612-613], and the Court of Appeals affirmed this finding [Appendix B].

Later Supplementary and Amendatory Agreements.

The original contract, entered into in 1945, called for six pictures. By the date of the 1958 trial, United had actually produced 11 motion pictures for Warner Bros. (the 11th picture had just gone into release in 1958).

These added pictures were provided for in a number of supplementary and amendatory agreements entered into (in addition to the 1947 agreement) between Warner Bros. and United over a period of years prior to the time of the 1958 trial; these agreements increased

the number of pictures and extended the term of the Warner-United agreement.

The District Court found that each and all of these supplemental and amendatory agreements were "fair and reasonable" [Find. XXV, R. 612-613], and the Court of Appeals affirmed this finding (Appendix B).

Petitioner's Accounting Claims, Newly Raised in 1958 —The Only Claims Presently Urged Upon This Court.

As stated hereinabove, based on evidence at the 1958 trial, Petitioner made several new alleged claims, mainly that certain accounting transactions were violations of the agreements between Warner Bros. and United, as Petitioner sought to interpret them.

Although these claims were not contained in the complaint, the District Court ruled that Petitioner had the right to advance them, under Rule 54(c) of the Federal Rules of Civil Procedure [Appendix A].

Under the circumstances, the District Court suggested to the parties that it might be advisable, since these alleged accounting claims were just newly made and had not been prescribed to the Warner Bros. Board of Directors, to make such a presentation to the Warner Bros. Board [R. 780]. It should be particularly noted that Petitioner's repeated protestations in his Petition that he was prohibited by the District Court "to go to the Warner Bros. Board of Directors after ten years" are the grossest distortion of the facts, the District Court could not have made the suggestion earlier because Petitioner himself had not presented such claims earlier. Indeed

if the District Court had required Petitioner to file a supplemental complaint based on the new purported charges, as it might well have done, then Petitioner would have been compelled to present these claims to the Warner Bros. Board under the provisions of Federal Rules of Civil Procedure, Rule 23(b) [Appendix A] unless Petitioner could have advanced, which is highly doubtful, compelling reasons for not doing so.

In any event, the District Court did not compel Petitioner to make such submission, but left it to Petitioner to decide whether he would elect to make such submission [R. 786]. Petitioner elected to and did make such submission; the Warner Bros. Board of Directors caused an independent investigation to be made of Petitioner's claims; thereafter the Warner Bros. Board of Directors passed a resolution that "it is not to the best interests of the Corporation (Warner Bros.) to lend its sanction" to the proceedings in this case "either as included in the present complaint or in said complaint if amended to include any of the matters set forth in the letter of October 16, 1958" (which letter contained Petitioner's submission to the Warner Bros. Board) [R. 615-616].

The District Court found that the Warner Bros. Board of Directors, in considering and passing on said matters, "acted in good faith, without fraud, coercion or domination of any person or persons whatsoever"; that the directors "intended to and did act in the interests of Warner Bros. and exercised honest and honest in

dependent business judgment"; that "such matters were matters properly for said Board and properly the subject of the exercise by it of its said independent business judgment" [Rec. XXVII, p. 617], and disposed of said purported accounting claims under the Business Judgment Rule.

Summary of Argument

This Is Not a Proper Case for the Writ to Issue.

[illegible] rest on strictly factual determinations or strictly state law determinations. By policy and precedents this Honorable Court will not review the findings of fact or decisions on matters of state law, made by the District Court and affirmed by the Court of Appeals [illegible] the absence of unusual circumstances, which are not present herein.

[illegible] properly decided that the lease was valid and all amendments thereto were valid and assignable, and this determination has not in fact been contested either in the Court of Appeals or in this Honorable Court.

[illegible]

ARGUMENT.

I.

The Petition Presents No Questions Justifying a Hearing by the Supreme Court of the United States; the Questions Presented Are Either Strictly Factual or Strictly Matters of State Law; on All Such Issues, Both Courts Below Have Concurred.

A. The Two Key Issues Have Been Fact Issues; They Call for No Rehearing in This Court.

Court found, as a fact, that these matters were "properly the subject of the exercise by the Board of Directors of Warner Bros. of its said independent business judgment" that the board of directors "acted in good faith, without fraud, coercion or domination of any person or persons whatsoever," and that the decision of the board not to lend its sanction to any litigation or proceedings based on said alleged accounting errors, was the exercise by the board of "such independent business judgment" [Find. XXVII, R. 617]. This finding likewise was affirmed by the Court of Appeals [Appendix B].

This court should not be used and will not permit itself to be used, as a mere rehearing tribunal on plain factual issues on which the District Court and the Court of Appeals fully concurred.

> "A sure guide and well-established rule of this court makes concurrent findings of two courts below final here in the absence of very exceptional showing of error." *Comstock & Co. v. Group of Investors*, 335 U. S. 211, 215 (1947).
>
> "A court of law, such as this court is, rather than a court of equity, in reviewing findings and fact finding cannot undertake to review concurrent findings of [illegible] in the absence of a very obvious and exceptional showing of error." *Graver Tank & Mfg. Co. v. Linde Air Products Company*, 336 U. S. 272, 274 (1949).

B. **Such Legal Issues as Are Presented by the Petition Involve Strictly State Law Questions: Both Lower Courts Have Fully Concurred on the Rulings.**

There are no federal questions in this diversity case. The sole issue depends upon the determination and application of state law.

In *Cities Service Co. v. Dunlap et al.*, 337 U. S. 341 (1948), this court, in dealing with the subject of minority stockholder suits, unequivocally stated contrary to Petitioner's misleading quotation from this case:

> "We conclude the State has ample power over this type litigation . . .
>
> ". . . the wisdom and policy of this and similar statutes are involved in controversies widely debated in legal literature, but are not for us to judge and are not for us to remark upon." [p. 350.]

This honorable court has, by tradition and policy, consistently held that, in absence of very special circumstances, it would defer to determinations of local law made however only by the District Courts and the Courts of Appeals. *Woodbine Co. v. Muskogee Co.*, 340 U. S. 183, 190 (1950). "We of course usually accept state law as declared by the Court of Appeals"

[illegible] 834, 39 and his brief in the Court of [illegible] the question of which state's law should [illegible] and which was correctly determined by the District Court [illegible] the laws of the states concerned is essentially the same [illegible] such a "conflicts of law" question would [illegible] state law under the forum, California (*Klaxon Co. v. Stentor Electric Manufacturing Co.*, 313 U. S. 487 [1941]).

citations omitted) and we have no hesitation in doing so here when there is no indication that its conclusion as to state law is not correct."); *General Box Co. v. U. S.*, 351 U. S. 159, 165 (1955) ("We ordinarily accept determinations of Courts of Appeals on questions of local law and we do so here"); *Kapan v. Merchants Transfer Co.*, 337 U. S. 530, 534 (1948) ("We ordinarily accept the determination of local law by the Court of Appeals and will not disturb it here [citing cases]"); *Penn Mut. Ind. Ins. Co. v. Commissioner*, 335 U. S. 701, 708 (1948) "it is sufficient for us to say that we think reasonable arguments can be made based on Pittsburgh cases to support a determination of this question either for or against petitioner's contention. Under these circumstances, we will follow our general policy and not have undisturbed the Court of Appeals' holding as to [state law]." See also the recent cases of *Lumpkin v. Sheppard*, 358 U. S. 588 (1958) and *Gen. Atl. Ins. Co. v. Hakeki*, 358 U. S. 613 (1958).

[illegible] rule [illegible] this Court to accept the [illegible] made by the lower courts [illegible] this Court has [illegible] when such issues [illegible] As stated [illegible] *Mut. Life Ins. Co. v. Hurdt*, 354 U. S. 118, 120 (1957): "The Supreme Court, moreover, has always refused to exercise its discretion to accept every Court of Appeals decision alleged to conflict with applicable local law on the ground that application of state statutes and rules to diverse factual patterns [illegible] Unless the Court of Appeals [illegible] the Court is ready to give scant consideration

tion to a certiorari petition based upon such a conflict. The court uniformly declines review whenever the Court of Appeals has reached a reasonable and permissible result." See *McGregor v. State Mutual Co.*, 315 U. S. 280 (1942).

Petitioner, in attempting to create an aura of federal interest about his petition, has quoted indiscriminately from numerous federal cases. A careful reading of these cases shows, without room for doubt, that none of them is in point and that such quotations are out of context, or from dissenting opinions, or otherwise misleading. For example, Petitioner's lengthy quotation from *Cohen v. Beneficial Loan Corporation, supra*, seems to infer that the decision contained a ruling extending the protection accorded to minority stockholders. In fact, the case involved a state statute which was designed to protect corporations from "strike suits" brought by shareholders. This court upheld the right of a state to pass such legislation and then indicated it would be inappropriate for this court to pass on the wisdom of such legislation. This court stated, with respect to the remedy of a shareholders' derivative suit:

> "Unfortunately, the remedy itself provided opportunity for abuse, which was not neglected. Suit was sometimes brought not to redress real wrongs, but to realize on their nuisance value. They were bought off by secret settlements in which any wrongs to the general body of shareowners were compounded by the suing stockholders, who were well fed by payments from corporate assets. These litigations were aptly characterized in professional slang as 'strike suits' [page 548]".

This court further stated [at page 552]:

> "A *state* may set the terms on which it will permit litigation in its courts." (Emphasis added.)

Petitioner cites and quotes from *Koster v. Lumbermen's Mutual*, 330 U. S. 518, 538, but petitioner fails to indicate that he is quoting from a dissenting opinion. *North American v. Securities and Exchange Comm.*, 327 U. S. 686 and *United States v. Union Pacific Railroad*, 225 U. S. 123, cited by Petitioner, deal only with certain presumptions created under special *federal* statutes (concerning anti-trust and public utility holding company law) and have no conceivable relation to the issues of *state* law in this case. Similarly, *Woods v. City Bank*, 312 U. S. 262 and *Pepper v. Litton*, 308 U. S. 295 are concerned with proceedings under *federal* law (bankruptcy).

II.

In Any Event the Concurring Decisions of the District Court and the Court of Appeals on All Issues of the Case Are Clearly Correct; and This Petition Should Be Denied.

A. The Original and Basic Issue—the Validity of the Contract and Its Amendments—Is Essentially a Factual Issue; It Was Unequivocally Decided Against Petitioner by the District Court; the Court of Appeals Affirmed; on This Fundamental Issue Petitioner Has in Fact Conceded by Default.

As already explained above, the entire gravamen of Petitioner's complaint filed in the District Court in California in 1948 was the charge that the original contract and its amendments between Warner Bros. and United Artists Corporation, as the result of a fraudulent conspiracy between the brothers Warner, and the

remaining members of the Board of Warner Bros. and was unfair and unreasonable.

In 1953, the District Court, while disposing of the earlier question of federal jurisdiction, found that "the contract in controversy was made and entered into in good faith and without fraud . . . ." [Find. IV, R. 75]. This finding was sustained by the Court of Appeals in 1956.

In 1958, after the trial was resumed (following the decision of the question of federal jurisdiction), the District Court found "that the contracts, amendments and agreements . . . and each and all of them, were made and entered into in good faith and without fraud and were fair and reasonable . . ." [Find. XXV, R. 613].

These findings of the District Court in 1958 were so obviously supported by the evidence that Petitioner has not even contested them; his Briefs in the Court of Appeals, following the 1958 District Court judgment, nowhere challenged these findings as unsupported by the evidence. The petition for writ of certiorari filed by Petitioner herein likewise contains no challenge whatsoever to these findings.

B. The District Court and the Court of Appeals Properly Applied the "Business Judgment Rule" to the Claims Based on Certain Alleged Accounting Errors.

1. *The District Court's Findings of Fact on This Issue Were Sustained by the Court of Appeals, and Are Not Even Challenged Here by Petitioner.*

At the trial in 1958, the District Court decided that the alleged accounting errors raised by Plaintiff for the first time in said 1958 trial, were properly the sub-

ject of the "Business Judgment Rule," and, in that connection, made the following findings of fact:

"The Court finds that at the time of the adoption of said resolution, the Board of Directors of Warner Bros. consisted of nine members of whom eight were present; that seven, only, of said members considered the matters referred to by the plaintiff herein, and the report of the Board's investigation thereon, and voted thereon. That the members of said Board of Directors who voted were Charles Allen, Jr., Waddill Catchings, Stanleigh P. Friedman, Benj. Kalmenson, T. J. Martin, R. W. Perkins and Serge Semenenko. That the defendant, Jack L. Warner, a member of said Board, was not present at said meeting; that his brother Albert was present, but did not participate in the discussion or vote with reference to such matters.

"The Court finds that the said Board of Directors acted in good faith, without fraud, coercion or domination of any person or persons whatsoever; that in considering and passing upon said matters said Board and the members thereof intended to and did act in the interest of Warner Bros. and exercised its and their independent business judgment; and that its and their decision, as above set forth, was the exercise by it and them of such independent business judgment; that such matters were matters properly before said Board and properly the subject of the exercise by it of its said independent business judgment." [Find. XXVII, R. 616-17].

On the appeal to the Court of Appeals, Petitioner attempted to challenge these findings as unsupported by the evidence. The Court of Appeals sustained the findings of the District Court. [Appendix B].

In his Petition for Writ of Certiorari herein, Petitioner nowhere contends that the findings of fact on the Business Judgment Rule are unsupported by the evidence.

(2) The Local Law of the State of Incorporation Clearly Applies the Business Judgment Rule.

The local law governs all matters of substance in diversity cases: such local law is the federal courts' statutes, if any, but the decisions of the state courts as well. *28 U. S. C. 1652; Erie Railroad v. Tompkins*, 304 U. S. 64 (1938). Which state's law is controlling is determined by the conflicts law of the forum: here California. *Klaxon Co. v. Stentor Electric Manufacturing Co., supra.* The District Court correctly applied the California conflicts law in determining the applicable substantive law, and Petitioner's citations to attempt to show that the substantive law of Delaware should apply are not California cases[5] and do not deal with California conflicts law, and are of no relevance. In any event,

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[5]The District Court decided the conflicts of law question by specific reference to relevant California law [R. 807]. Although petitioner did not press this argument below, he cites two cases in his petition here to establish that the law of Delaware, the state of incorporation, should control. The first of these cases is *Havens v. Guaranty Trust Company*, 288 U. S. 123 (1932). It should be noted at the outset that this case was decided before *Erie v. Tompkins, supra*, which established the controlling nature of state law and before *Klaxon Co. v. Stentor Electric Manufacturing Co., supra*, which established the rule requiring that the conflicts of law rules of the forum should be applied. Moreover, in the *Havens* case and in the case of *Perlman v. Feldmann*, 219 [illegible] involved were characterized as "internal affairs" of the corporation—matters strictly between the shareholders and directors with no outside parties involved. Clearly, those issues are of a different nature than those here being contested, which involve contractual relations between the corporation and outside parties. In any event, as already indicated, it is the California conflicts rules which govern, and the District Court correctly determined

there would be no occasion for any dispute over which state's law should here apply. The laws of the states of California, Delaware and New York, equally apply the Business Judgment Rule. *Findley v. Garrett*, 109 Cal. App. 2d 166, 240 P. 2d 166, 240 P. 2d 421 (1952); *Davis v. Louisville Gas & Elect. Co.*, 16 Del. Chanc. 157, 142 Atl. 654; *Blaustein v. Pan American Petroleum and Transport Co.*, 293 N. Y. 281, 56 N. E. 2d 705; *Hornstein v. Paramount Pictures Inc.*, 37 N. Y. S. 404 (1942).[3]

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[3]Petitioner cites a number of Delaware cases in a seemingly half-hearted attempt to indicate that the law of Delaware does not recognize the business judgment rule. Even if the Delaware law were applicable (and it is not), petitioner's cases do not support his argument. He quotes at great length from the case of *Gottlieb v. Hayden Chemical Corporation*, 33 Del. Chanc. 82, 87, 90 A. 2d 660 (1952). The material that he neglects to quote, coming directly before the material that he does quote, indicates the baselessness of his contentions. The court stated [at p. 663]:

> "We recognize the force of the universally acknowledged principle of law which leaves many matters to be finally settled by the sound business judgment of the directors . . ."

The court then went on to note that in the case before it, the majority of the directors had enriched themselves by the actions complained of. In the case of *Yeaw v. Bellesey*, 27 Del. Chanc. 381, 30 A. 2d 808, cited by petitioner, the court accepted as a fact on demurrer that the corporation had "no officer or director with an uncontrolled and unbiased mind." This case is clearly opposite to the present situation where the finding is exactly to the contrary. The other case cited by petitioner from Delaware, *Frankel v. Donovan*, 130 A. 2d 511, is basically the same in nature as the case of *Gottlieb v. Hayden Chemical Corporation*, *supra*.

That the Business Judgment Rule is applied in Delaware is made unequivocally clear in *Davis v. Louisville Gas & Electric*, *supra*:

> "The reason which courts advance for such application is that it is not their province to resolve what are really questions of policy and business management. The directors are chosen to pass upon such questions and their judgment, when shown to be tainted with fraud, is accepted as final. The judgment of the directors of corporations enjoys the benefit of the presumption that it was formed in good faith and was designed to promote the best interests of the corporation they serve" [p. 660].

C. The Business Judgment Rule Is Clearly Applicable and Was Properly Applied.

The Business Judgment Rule, stated plainly, is this: where the Board of Directors of a corporation acts in good faith and free from domination, the court will not, in a minority stockholders' suit, supersede the Board of Directors' judgment with the judgment of the court.

It would be difficult for business in this country on the one hand, and for the courts in this country on the other, to function if every corporate business judgment, however honestly and freely arrived at, would be subjected to judicial reversal at the instance of a minority stockholder who claimed the judgment was wrong.

The leading case in California, indeed one of the leading cases on this matter in the United States, is *Findley v. Garrett* (1953), 109 Cal. App. 2d 166, 240 P. 2d 421. In that case the court said [p. 174]:

> "The power to manage the affairs of a corporation is vested in the Board of Directors. (*Scott v. Los Angeles Mountain Park Co.*, 92 Cal. App. 258, 264 [267 P. 914].) Where a board of directors, in refusing to commence an action to redress an alleged wrong against a corporation, acts in good faith within the scope of its discretionary power and reasonably believes its refusal to commence the action is good business judgment in the best interest of a corporation, a stockholder is not authorized to interfere with such discretion by commencing the action."

Findley v. Garrett, has been followed in subsequent California cases and is clearly the present law of California:[4]

> *Thomas v. Summers Gyroscope Company* (1958), 160 Cal. App. 2d 234, 324 P. 2d 893;
>
> *Olson v. Basin Oil Co.* (1955), 136 Cal. App. 2d 543, 288 P. 2d 952.

In general, petitioner's attack on the application of the Business Judgment Rule by the District Court (and affirmed by the Court of Appeals) consists of the following:

(a) *Petitioner Repeatedly Contends That the Rule Should Not Be Applied When the Board Is Not Free and Not Independent. On This There Is No Conflict. We Consider This to Be Part of the Rule Itself.*

But in this case, the District Court has found twice [1953 Find. IV. R. 74-75; 1958 Find. II. R. 602] that the Warner Board was free and independent. The

[4] Petitioner cites three cases from California as being contrary. Only one of these cases, *Wickersham v. Crittenden*, 93 Cal. 17 (1892), involved a shareholders' derivative suit. Moreover, that case contained allegations that only two out of the five directors approved the actions complained of and further allegations that the board of directors was not properly constituted, elected, or [illegible] *Heaton v. Marshall*, 166 Cal. 185 (1913), cited by petitioner does not involve a shareholders' derivative suit but, on the contrary, was *brought by the corporation* against a director, claiming that he made secret profits without the knowledge of the other directors. *Kennerson v. Burbank Amusement*, 120 Cal. App. 2d 157 (1953), also did not involve a shareholders' action. This was a case in which a plaintiff tried to enforce a contract with the corporation; the corporation, *acting through its board of directors*, argued it was void; that situation is the exact opposite of the situation now before the court.

Court of Appeals on the first appeal, reviewed the record and found no occasion for reversal on the facts [R. 669] and again affirmed the comparable findings on the second appeal. [See Appendix B, opinion of Court of Appeals.]

(b) *Petitioner Contends That "Effective Working Control" of the Corporation or "Working Stock Control" of the Corporation Are the Same as "Domination" of the Board of Directors, and Means That the Board Is Unable to Exercise Any Free or Independent Judgment by Reason of Such Control.*

This contention is unsound.

One of the clearest analyses of the distinction between these concepts is from an earlier case in the Ninth Circuit: *Cowell v. McMillen* (9th Cir., 1910), 177 Fed. 25.

In the *Cowell* case, Cowell sued McMillen derivatively in the name of the Tacoma and Roche Harbor Lime Company, alleging that McMillen owned the majority of the stock of the corporation, and elected directors who, because McMillen elected them, obeyed his directions in operating the corporation to his benefit and to the corporation's detriment. There were further allegations that the directors voted excessive salary to McMillen, fraudulently issued bonds to McMillen and that he used the assets of the corporation to his personal advantage and to the advantage of another corporation owned by him. It was also alleged that he entered into a leasing contract with the corporation unfair to it and to the benefit of his privately owned corporation. The court, after first noting that Mc-

Millen was not a majority shareholder at the time the original contracts were made, agreed that he was a majority shareholder at the time the contracts were renewed. The court then stated, at page 42 of the opinion:

> "It is insisted, however, that the directors were dummies when they voted for the renewals, because they were elected by the vote of McMillen, the holder of the majority of the shares of stock. In the sense that they owed their positions as members of the board to McMillen, complainant is correct; but, in the sense that they were mere creatures, willing or obligated to do McMillen's bidding, and to aid him in executing fraudulent designs, or knowingly to do any act beyond the law, or that was unfair or oppressive, or against the defendant company's interest, the contention is without merit."

There are thousands of public corporations in this country in which there are stockholding groups of sufficient size and character to permit such groups to elect a majority of a board of directors. Countless men of integrity—lawyers, business men, doctors, engineers, bankers and others—accept positions on boards of directors at the suggestion of such groups able to elect a majority of the board. Does this mean that any person who under these circumstances consents to become a member of a board of directors has *ipso facto* become a fraud, a person who has no integrity, and who would automatically be dominated to vote to approve any fraudulent act perpetrated on the corporation by the stockholders who elected him to the directorate; that he will become part of a conspiracy to per-

mit the stealing of funds and assets from a publicly held corporation?

Consider the incredible enormity of the position which petitioner asks this court to take. Here the District Court has found, not that there was insufficient evidence to show domination, but has found affirmatively that:

> ". . . the said Board of Directors acted in good faith, without fraud, coercion or domination of any person or persons whatsoever . . ." [Find. XXVII, R. 617].

The Court of Appeals sustained this finding. Nowhere in his petition for writ of certiorari has petitioner argued that this finding was unsupported by the evidence. What petitioner appears, in reality, to be arguing is that this court should establish a presumption, as the law of the land, that any person who is elected to a directorship of a public corporation by the votes of another person or group of persons is, thenceforth, deemed to be dishonest and corrupt. Indeed, in asking this court to disregard the findings of the District Court in this case, petitioner is, shockingly, asking this court to establish a *conclusive* presumption of dishonesty and corruption. Such a pronouncement would sever the very roots of our fundamental concepts of law in this country; and it would be an unthinkable misrepresentation of the basic integrity of its people.

A case passed upon by this court with interesting parallels to the one at hand is *Comstock v. Group of Investors*, 335 U. S. 211 (1947). In that case, the petitioner was a shareholder in a subsidiary of a railroad company. The companies had been in reorganization under Section 77 of the Bankruptcy Act and a plan of

reorganization had been approved by the Interstate Commerce Commission. The petitioner objected to the approval of the plan contending that the parent had dominated and controlled the subsidiary and had mismanaged its affairs to the detriment of the subsidiary. The petitioner urged, therefore, that a large claim of the parent against the subsidiary should not be allowed as was proposed in the plan of reorganization. This court first reprimanded the petitioner for departing from his assurances that there was no *factual* controversy—noting that his arguments were essentially of a factual nature with respect to domination and control, and the effect thereof. This court then noted that it had discussed remedies for breach of fiduciary duty in cases such as *Pepper v. Litton*, 308 U. S. 295 (cited by petitioner in this case) but that

> ". . . petitioner asks us to declare the same result in this case, despite explicit and unchallenged findings that in its dealings with the (subsidiary) during the period involved, the (parent) acted in good faith and with due regard to its obligations, legal and equitable, to the subsidiary and its securities holders. [P. 228].
>
> ". . . it is not a mere existence of an opportunity to do wrong that brings the rule into play; it is the unconscionable use of the opportunity . . ." [P. 229].

As is true in this case, this court further noted that the criticized transactions were "beneficial rather than injurious to the interests which now challenged them." [P. 230]. This court also finally said:

> ". . . The findings to that effect are entitled to special weight where as here, they are based on

> the district judge's complete familiarity with the case [citing cases]. Affirmed by the Circuit Court of Appeals, they are, under the rule concerning concurrent findings, and on the basis of our grant of certiorari, conclusive in this court." [p. 230].

(c) *Petitioner Contends That the Business Judgment Rule is Not Applicable Where Fraud (Including Breach of Trust, Divided Loyalty and the Like Is Involved).*

The leading California case of *Findley v. Garrett, supra*, disposes of this contention. In the *Findley* case, the complaint alleged fraud (including divided loyalty charges, etc.). The court, stated:

> "Directors have the same discretion with respect to the prosecution of claims on behalf of the corporation, as they have in other business matters. In this respect, the fact that a claim may be founded in fraud does not differentiate it from other claims. . . . Refusal to sue on a fraud claim is not, as plaintiff contends, a ratification of fraud. . . ." [109 Cal. App. 2d at 177.][5]

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[5]Petitioner cites *Bayer v. Beran* (1944), 49 N. Y. S. 2d 2, as purportedly stating an exception to the Business Judgment Rule which makes the Rule inapplicable in cases where some of the members of the board of directors have so-called "divided loyalty." The actual basis of the decision of the court (which was a decision of a *state* trial court) is not entirely clear. See, for example, the statement at page 15 of the court that "on the entire case, the directors acted in their free exercise of their business judgment. . . ."

To the extent that *Bayer v. Beran* purports to make such an exception as petitioner contends for, it is not in keeping even with the law of New York. See *Lasdon v. Lasdon* (1945), 50 N. Y. S. 2d 800, 268 App. Div. 455, a later New

(d) *Petitioner Distorts the Facts to Contend That a "Gift" is Here Involved.*

Petitioner's frequent innuendoes and assertions that there were "gifts" in this case are a baseless canard. As pointed out above, at the end of the 1958 trial, petitioner, for the first time, asserted certain accounting errors. Petitioner's principal accounting arguments were so involved that they required complex charts, prepared by a certified public accountant, hand picked by petitioner; and such charts were based on self-supporting assumptions of contract interpretation which were supplied to such accountant by petitioner. We deny the validity of petitioner's claims of accounting error. But to say that a corporation, if it were in error in the course of a good faith resolution of an accounting problem, is making a "gift" is plainly contrived and fanciful. Coupled with petitioner's further suggestion that a gift is "ultra vires," the result would be complete chaos in the business life of this country. Thousands of corporate transactions every day, involving good faith resolutions of differences with third parties, or merely involving good faith determinations of accounting practice, would never have finality; on petitioner's contention that if there was an error, then there was a "gift," any stockholder could require a judge to impose his view of the correctness of a good faith business determination. Petitioner's contention is a complete distortion of the concept of "gift," and would virtually emasculate the

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York *appellate* decision which involved so-called divided loyalty and in which the court applied the Business Judgment Rule, commenting about its proper application where a majority of the board expressing its judgment is honest and free of domination.

In any event, the California decision of *Findley v. Garrett*, [illegible] is both correct on principle, and controlling.

well-founded and vitally necessary Business Judgment Rule. Neither logic, public policy nor authorities support petitioner's contention.

(c) *Petitioner Makes Several Other Passing Objections to the Application of the Business Judgment Rule Which Can Be Disposed of Summarily.*

Petitioner contends that the rule was unfairly applied because he was *compelled* to submit his newly alleged accounting claims to the current Warner Bros. board of directors.

It is very clear from the record that the court *did not order* petitioner to make any such submission. At page 786 of the record, the court states: "I am not directing it to be done. I am offering you the opportunity to do it. I offer either party the opportunity to do it and to await judgment until it be done."

Petitioner further charges unfairness to the District Court by implying that the District Court ruled adversely on a request actually made by Petitioner to bring the directors in to testify following the aforesaid submission. Petitioner's references to the record in this connection indicate a running colloquy with the court on this matter; however, petitioner *never* moved the court for permission; the District Court, accordingly, made no ruling, formally or informally [R. 761-786].

D. Regardless of the Business Judgment Rule, the Petitioner Could Not Have Prevailed in His Alleged Accounting Claims; the Record Clearly Demonstrates That the Transactions Complained of Were Fair and Reasonable.

In this brief in opposition to granting the writ of certiorari, it would be impracticable to go into the fairness of the accounting transactions complained of. If it

were necessary, however, the court's attention is directed to the record of the case, which we believe will unequivocally establish the complete fairness and reasonableness of all of such transactions.

Conclusion.

It is respectfully submitted that the petition before this court presents no new issues, nor any issues of general interest; that it does present only issues of fact and local law; that even on these, the petition is clearly without merit; and that therefore petitioner has made no showing that he is entitled to the issuance of the writ.

> "The jurisdiction (of the Supreme Court to review cases by way of certiorari) was not conferred upon this court merely to give the defeated party in the circuit court of appeals another hearing."
>
> *Mangmun v. Coty*, 262 U. S. 159, 163.

Respectfully submitted,

OLIVER B. SCHWAB,

HAROLD S. KANT,

Counsel for Respondents, United States Pictures, Inc. and Milton Sperling.

APPENDIX A.

RULE 54.

JUDGMENTS; COSTS

"(c) *Demand for Judgment.* A judgment by default shall not be different in kind from or exceed in amount that prayed for in the demand for judgment. Except as to a party against whom a judgment is entered by default, every final judgment shall grant the relief to which the party in whose favor it is rendered is entitled, even if the party has not demanded such relief in his pleadings."

RULE 23.

CLASS ACTIONS

"(b) *Secondary Action by Shareholders.* In an action brought to enforce a secondary right on the part of one or more shareholders in an association, incorporated or unincorporated, because the association refuses to enforce rights which may properly be asserted by it, the complaint shall be verified by oath and shall aver (1) that the plaintiff was a shareholder at the time of the transaction of which he complains or that his share thereafter devolved on him by operation of law and (2) that the action is not a collusive one to confer on a court of the United States jurisdiction of any action of which it would not otherwise have jurisdiction. The complaint shall also set forth with particularity the efforts of the plaintiff to secure from the managing directors or trustees and, if necessary, from the shareholders such action as he desires, and the reasons for his failure to obtain such action or the reasons for not making such effort."

APPENDIX B.

United States Court of Appeals for the Ninth Circuit.

Charles B. Smith, as Special Administrator of the Estate of Edward S. Birn, Deceased, Appellant vs. Milton Sperling, *et al.*, Appellees. No. 16,387. April 20, 1960.

Appeal from the United States District Court for the Southern District of California, Central Division.

Before: Chambers, Magruder and Jertberg, Circuit Judges.

Per Curiam.

This case was up on appeal previously, Smith v. Sperling, 237 F. 2d 317 (C. A. 9th, 1956), rev'd 354 U. S. 91 (1957).

It started by the filing on December 15, 1948, of a typical minority stockholder's derivative suit brought by the plaintiff, a citizen of New York, against Warner Bros. Pictures, Inc., and United States Pictures, Inc., both Delaware corporations, and against certain named individuals, Harry M. Warner, Jack L. Warner, and Milton Sperling, all citizens of California. Sperling was the son-in-law of Harry M. Warner. Originally the complaint contained three causes of action, but the third suit was dismissed without prejudice several years ago, and we are now concerned only with the first and second causes of action.

The first, brought against all the defendants, charged that a certain contract for the production of motion pictures, and subsequent modifications thereof, had been made improperly by Warner Bros. Pictures, Inc., with United States Pictures, Inc., as a result of domination of the former corporation by the stock control of the

Warner brothers, for the purpose of enriching United States Pictures, Inc., and its president, Milton Sperling, at the expense of Warner Bros. Pictures, Inc. The relief sought was the cancellation of the contract. This relief has now become moot with the expiration of the contract, and what the minority stockholder is presently seeking is a financial reimbursement to Warner Bros. Pictures, Inc., for errors or misrepresentation of the contract during the time it was being administered.

After a lengthy hearing, the district court found as a fact that though the individual defendants, the Warner brothers, had sufficient stock ownership to control the election of the directors of Warner Bros. Pictures, Inc., such directors were not, as alleged in the complaint, "dominated" by them, but had approved the contract in good faith and in the exercise of their independent business judgment as being a sound business arrangement for the best present and future interest of Warner Bros. Pictures, Inc. Therefore the district court thought that, so far as the first cause of action was concerned, Warner Bros. Pictures, Inc., should be realigned as a party plaintiff, and as thus realigned there would be no diversity of citizenship. Hence the district court entered an order dismissing the first cause of action for lack of jurisdiction. Smith v. Sperling, 117 F. Supp. 781 (S. D. Cal. 1953).

The second cause of action was different in that United States Pictures, Inc., was not named as a defendant, and the complaint charged mismanagement of Warner Bros. Pictures, Inc., by the individual defendants as officers and directors of the corporation, all to the large pecuniary loss of the corporation. This cause of action the district court also dismissed, but on the merits for lack of equity.

On appeal this court thought the district court was right as to the first cause of action, but reversed its action as to the second and remanded the case to the district court for trial on the merits of the second cause of action. 237 F. 2d 317. Upon certiorari issued by the Supreme Court, that Court held, as to the first, that whether or not the directors of Warner Bros. Pictures, Inc., were "dominated" by Messrs. Warner, as to which the Supreme Court of course did not undertake to decide, nevertheless if the corporation through its board of directors refused to bring a suit, even though the directors were acting independently and in good faith, it was improper for the district court to realign the corporation as a party plaintiff and thus to defeat the federal jurisdiction. Accordingly, in reversing our determination, the Supreme Court remanded the case to the district court for trial of the first cause of action on the merits. 354 U. S. 91.

Because there was some overlapping of the jurisdictional issues as conceived by the district court and the issues on the merits, the earlier trial in the district court was very extensive. It was stipulated that all the evidence taken at the first trial should be considered on the merits.

The district court, pursuant to the remand, resumed its hearings and much further evidence was offered and received. Appellant offers no objection that any evidence on his behalf was improperly excluded. Finally, on December 17, 1958, a new set of findings was issued by the district court, and judgment was entered on the basis of these findings dismissing both the first and the second causes of action on the merits. The judg-

ment now on appeal specifically contained a clause stating that:

"[T]his judgment of dismissal shall not operate as an adjudication upon the merits as to any claims arising from alleged non-performance or breach of any contract, or amendment or supplement thereto, between Warner Bros. Pictures, Inc., and United States Pictures, Inc.; nor as to any claim arising from the payment by Warner Bros. Pictures, Inc., of $78,000 as 'severance pay' to Joseph Bernhard."

On the findings of fact by the district court, which seem to us to be adequately supported by the evidence, we think that the district court's judgment of dismissal was inevitable and correct. There is no doubt that the production contract with United States Pictures, Inc., proved in operation to be very lucrative to Warner Bros. Pictures, Inc. Under the contract, Warner Bros. Pictures, Inc., received and handled all the gross receipts from the exploitation of the pictures and allocated the same in accordance with its terms. There was testimony by an employee of Price, Waterhouse & Company, independent auditors for both corporations, that the accounting practices of each were in accordance with the practices acceptable in the industry. Appellant does not claim that defendant, United States Pictures, Inc., diverted to improper uses any of the gross receipts. The trial judge found, as he had in substance found previously, as follows:

"The Court finds that the said Board of Directors acted in good faith, without fraud, coercion or domination of any person or persons whatsoever; that in considering and passing upon said matters said Board and the members thereof intended to and did act in the

interest of Warner Bros. and exercised its and their independent business judgment; and that its and their decision, as above set forth, was the exercise by it and them of such independent business judgment; that such matters were matters properly before said Board and properly the subject of the exercise by it of its said independent business judgment."

A judgment will be entered affirming the judgment of the District Court.

(Endorsed) Per Curiam Opinion Filed April 20, 1960.

Frank H. Schmid, Clerk.

Office-Supreme Court, U.S.
FILED
AUG 11 1960
JAMES R. BROWNING, Clerk

FILE COPY

IN THE

Supreme Court of the United States

October Term 1960

No. 245

CHARLES B. SMITH, as Special Administrator of the Estate of Edward S. Birn, Deceased,

Petitioner,

vs.

MILTON SPERLING, JACK L. WARNER, UNITED STATES PICTURES, INC., WARNER BROS. PICTURES, INC., and HERBERT FRESTON, MILTON SPERLING, REA E. WARNER and DORIS WARNER VIDOR as Executors of the Estate of Harry M. Warner, Deceased,

Respondents.

Brief of Jack L. Warner, Warner Bros. Pictures, Inc., and the Executors of the Estate of Harry M. Warner, Deceased, in Opposition to Petition for Certiorari.

RALPH E. LEWIS,
EUGENE D. WILLIAMS,
650 South Spring Street,
Los Angeles 14, California,
Attorneys for Respondents, Jack L. Warner, Warner Bros. Pictures, Inc., and the Executors of the Estate of Harry M. Warner, Deceased.

FRESTON & FILES,
H. R. KELLY,
Of Counsel.

Parker & Son, Inc., Law Printers, Los Angeles. Phone MA. 6-9171.

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MILTON SPERLING, JACK L. WARNER, UNITED STATES PICTURES, INC., WARNER BROS. PICTURES, INC., and HERBERT KRALTON, MILTON SPERLING, JACK L. WARNER and LOUIS W. ORNER, WILLIAM as Executors of the Estate of Harry M. Warner, Deceased,

Respondents.

Brief of Respondents, Warner Bros. Pictures, Inc., Jack L. Warner, and the Executors of the Estate of Harry M. Warner, Deceased, in Opposition to Petition for Writ of Certiorari.

The Petitioner seeks review of a decision of the Court of Appeals for the Ninth Circuit affirming a judgment of dismissal by the District Court in a shareholder's derivative suit. Federal jurisdiction is based upon diversity of citizenship. The question of federal jurisdiction in this case was decided by this Court in 1957 (*Smith v. Sperling*, 354 U. S. 91, 1 L. Ed. 2d 1205, 77 S. Ct. 1112). Pursuant to the applicable mandates of this Court and of the Court of Appeals hereon, the trial was resumed in April 1958, at which time it was stipulated that all evidence theretofore taken in the 1954 trial should be considered, and addi-

tional evidence was taken. Findings and judgment adverse to the Petitioner were made in December 1958. The Petitioner then appealed to the Court of Appeals which affirmed; its opinion, rendered April 1960, being reported in 277 F. 2d 634. A copy appears in the Appendix to the Petition herein, and in the Transcript of Record hereon, pages 842 to 845 inclusive. References will be to such copy in the record.

Though the Petition does not anywhere so state, or even indicate, the judgment below covers two separate aspects as to which the dispositions were different. The basic claim had been made by Petitioner that the contracts between the corporate Defendants were invalid and should be set aside as having been obtained through the improper influence of the individual brothers Warner. Up to the time of the decision by this Court on the question of jurisdiction in 1957, this claim, which alone is reflected in the pleadings, was the sole claim. The present judgment of the District Court and the decision of the Court of Appeals dispose of that basic issue completely and on the merits. Subsequent to the remand by this Court and during the 1958 trial, Petitioner sought to show that there had been maladministration and certain accounting and interpretive errors of and under those contracts. It was with respect to these subsequent claims, differing in nature from the original and basic contention, that the trial court determined that Petitioner was precluded from asserting such claims under state laws that he had no standing to maintain the claims in the face of a decision by the Board of Directors of Warner that it was not in the interest of the Corporation to sanction the effort of the Petitioner with respect to those claims. The judgment was, therefore, that of dismissal on the mer-

its of the basic claim, but without determination of the merits of such subsequent claims.

Since we do not believe that the questions actually involved in this case are those set forth in the Petition, and since we do not believe the status and posture of the case have been adequately or fairly set forth in the Petition to enable the true questions to be evident, we feel it necessary at this point to restate the situation. It is submitted that an appreciation of the actual situation will show only that Petitioner disagrees with the Court of Appeals on the question of whether the evidence supports the Findings upon which the judgment is based.

Statement of the Case.

On the former presentation to this Court only the issue of jurisdiction was present, but in connection therewith there had been a lengthy trial resulting in Findings of Fact adverse to the Petitioner upon the question of the existence of fraud or other improper influence in the establishment of the contractual relationship between Warner and United. This Court noted (354 U. S. 91 at 95) that:

> "The gist of the findings of the District Court is that since there was no fraud on the part of the directors in making the contracts but only an exercise of independent business judgment, the management was not antagonistic to the financial interests of the corporation."

The facts, so found after a preliminary trial, were deemed by this Court to go to the merits and to be inapplicable in their relationship to and effect upon federal jurisdiction. It held that for the establishment of

jurisdiction, the matter of "antagonism" was to be determined from the face of the pleadings and the nature of the controversy (354 U. S. 91 at 96).

At the second hearing in 1958, since the first hearing had been extensive and the facts there adduced, and erroneously applied by the trial court on the matter of jurisdiction, were directly relevant on the merits, it was stipulated that all the evidence at the first hearing should be considered on the merits [R. 699; Op., R. 844]. At such 1958 hearing much additional evidence was presented, most of which related to the subsequent claims already mentioned. The facts relating to the claim of basic invalidity of the contracts remained and now remain substantially the same as they had been presented in 1953, but have been applied to determine the validity of the contracts instead of the question of federal jurisdiction. With respect to the facts, the Court of Appeals has twice examined the record, and each time determined that the evidence supported the Findings. It so stated on the first appeal (237 F. 2d 317 at 325(9)). On the second appeal the Court of Appeals said [R. 844]:

> "On the findings of fact by the district court, which seem to us to be adequately supported by the evidence, we think that the district court's judgment of dismissal was inevitable and correct."

With respect to the first aspect of the case, *i.e.*, the validity of the contract, and which issue was and is the only one presented by the pleadings, the District Court found that such contracts had been made with the approval of the Board of Directors of Wismer, that such Board was free from control or domination by

the individual Defendants named, had been considered in good faith by the Board and approved in the exercise of its independent business judgment without fraud, coercion or domination. In addition, it found the vital fact that the contracts themselves were fair and reasonable [Finding XXV, R. 612, 613] For convenience, a copy of Finding XXV is printed in the Appendix hereto.

At the close of its former opinion in this case, this Court said (354 U. S. 91 at 97):

> "A trial may demonstrate that the stockholder is wrong and the management right. It may show a dispute that lies in the penumbra of business judgment unaffected by fraud. But that issue goes to the merits; not to jurisdiction."

This is exactly what did happen with respect to basic validity. The evidence did demonstrate that the Petitioner was wrong and the corporation was right, and that the contracts were not only fair, reasonable and free of impropriety, but were also very lucrative to Warner. Such trial also showed that both the making of the contracts and the refusal years later to sanction this suit were proper exercises of business judgment.

With respect to the second portion of the case involving the subsequent claims of accounting error and maladministration, the trial court found [Finding XXVI, R. 613, 614] that during the trial the Petitioner had raised issues not presented by the pleadings relating to matters of interpretation of the contracts and accounting practices and lists those claims in essence. The story of the presentment of those claims to the 1958 Board of Directors of Warner is described fully

by the trial court in Finding XXVI [R. 614-617 incl.]. This Finding shows that in 1958, during the trial, Petitioner did present these subsequent claims in writing to the Board of Directors, but such Board employed the law firm of Dewey, Ballantine, Bushby, Palmer & Irvine (of New York) to investigate the law and facts involved and advise the Board, and that after receiving the report and advice of these consultants, the Board formally determined that it was not of the best interests of the corporation to sanction the efforts of the Petitioner in connection therewith. The Finding names the seven members of such Board who unanimously took such action. Neither Jack L. Warner nor Albert Warner participated. (Note: Harry M. Warner was then deceased.) As part of that Finding and with respect to that action, the trial court also determined that in so doing the Board acted in good faith without fraud, coercion or domination, in the interests of the corporation and in the exercise of proper independent business judgment. This portion of Finding XXVI is quoted in the Opinion of the Court of Appeals herein [R. 845, and Op. App. Pet. p. 4]. A copy of this Finding XXVI is printed in the Appendix hereto for the convenience of this Court.

It was with respect to the subsequent matters considered in Finding XXVI that the Court concluded that the Petitioner as the Plaintiff under such circumstances, had no right or standing to sue derivatively [R. 618, Conclusion of Law V].

We further believe it well to point out that the Court of Appeals in its Opinion specifically noted that the contracts and the operations thereunder had proved to be very lucrative to Warner Bros. Pictures, Inc.,

and that with relation to the asserted claims involving accounting practices, the firm of Price Waterhouse & Co. had been the independent auditors for each of the corporations, and that the accounting practices of each were in accordance with the practices acceptable in the industry [R. 844-845]. These views of the Court of Appeals show its belief that the business judgment of the Board of Directors had been good, and also and even though the trial court had not decided the merits of the subsequent claims, that such claims actually had little merit. There was no evidence whatever showing or tending to show that if any such errors in administration had actually occurred, they had been made "purposefully" to enrich United as Petitioner asserts (*cf.* Pet. p. 6).

Questions Presented.

The Petition herein does not reflect any of the typical grounds for Certiorari suggested in Rule 19 or otherwise recognized by this Court, but only a desire that this Court reconsider the evidence and accept Petitioner's version thereof. The question, therefore, is whether this Court should grant Certiorari to review a very extensive record and determine whether the evidence supports the Findings, after the Court of Appeals has twice examined that record and determined that such Findings had adequate support, when such Findings have determined

(a) that the basic contracts had been made and entered into in good faith, were fair and reasonable, were intended to be and were considered by the Board of Directors of the corporation to be sound business arrangements for the best present

and future interests of the corporation, and that such Board had not been affected by fraud or subjected to coercion or improper domination, and

(b) that the subsequent claims, relating to asserted accounting and administrative errors, had been presented to and considered by the Board of Directors, and such Directors had in good faith, without fraud, coercion or domination, acting in the interests of their corporation and in their independent business judgment, declined to sanction the prosecution of such claims by the Petitioner."

ARGUMENT.

The facts as found are clear and complete with respect to each aspect of this case. There remains to be considered only what is the law applicable to those facts, and whether those facts, in the light of the law, justify the judgment. If they do, as we shall show herein, then it is plain that Petitioner is seeking merely a reconsideration of the evidence in an effort to obtain different Findings.

I.

The Governing Substantive Law Is State Law.

In this case, as in any stockholder's derivative action, the governing substantive law is state law. This Court in its former Opinion herein said (354 U. S. 95),

"'Since our decision in *Erie R. Co. v. Tompkins*, 304 U. S. 64, the law which governs the merits in these derivative actions is local law. *Cohen v. Beneficial Industrial Loan Corp.*, 337 U. S. 541, 555, 556.'"

II.

The Judgment Here Is In Accordance With State Law (A) on the Merits as to the Basic Validity of the Contracts, and (B) on the Right of the Plaintiff to Maintain the Action With Respect to the Subsequent Claims.

(A) The Basic Contracts.

The basic contract made in 1945 and the subsequent amendments thereof were found to be fair and reasonable and in the financial interests of the corporation. They were entered into in good faith, and the action of the Board of Directors of Warner in approving them was found to be free of fraud, coercion or improper influence or domination by the individual defendants, and a proper and independent exercise by the Board of its discretion. [Findings XIV, R. 600-605; XVII, R. 606; XXII, R. 610-611; XXV, R. 612-613.] The facts so found with respect to the contracts justify the judgment under the requirements and standards of any and all of the state decisions or their federal counterparts which are cited by Petitioner or which are discussed herein. Such authorities, being primarily presented by Petitioner in connection with the so-called subsequent claims, are best considered in connection with that aspect of the case.

(B) The Subsequent Claims.

With respect to the subsequent claims, the Courts below have concluded that the Petitioner is not entitled to proceed on behalf of Warner in the prosecution thereof. In attacking this result, Petitioner purports to state his contentions in the Court Below (Pet. pp. 15 [illegible] and if such statement is intended as an argu-

at anyone's instigation. Furthermore, with respect to the Bernhard payment, the record shows that for a long time the practice of Warner had been to provide six-months' severance pay for executive employees who had been with the company for many years [R. 451], that Bernhard had been with the company for at least 15 years [R. 339 and 472], and that Bernhard's salary at the time of severance was $3,000.00 per week [R. 333]. Such payment was made in accordance with practice to a person qualified under that practice, and the amount was in accordance with that practice.

The issue upon the relevant Findings is whether Petitioner had a right to maintain the action. The action was brought and has been twice tried in California. California is the state of the forum, and the question as to whether an action can be maintained in California is peculiarly a matter of California law. However, with respect to the right of a shareholder to maintain a derivative suit, the laws of California and Delaware, as well as the general federal concept, adopt the same theories, standards and determinative elements, all of which are met by the Findings herein.

(a) *The California Cases.*

The law of California directly relevant to the matter is clearly set forth in *Findley v. Garrett* (1952), 109 Cal. App. 2d 168, 240 P. 2d 424; and *Fornaser v. Cosmosart Realty & Bldg. Corp.* (1929), 96 Cal. App. 549, 274 Pac. 597. A Petition For Hearing by the Supreme Court of California in the *Findley* case was denied (109 Cal. App. 2d at 180), and the case was commented upon with approval in *Olson v. Basic Oil Co.* (1955), 136 Cal. App. 2d 543 at 550; 288 P. 2d 952 at 962; where the rule of *Findley* is described

as "wholesome." No decisions adversely criticizing *Findley* have been found.

In *Findley v. Clarence*, *supra*, the court said (100 Cal. App. 2d 186 at 174, 240 Pac. 421 at 426):

> "The power to manage the affairs of a corporation is vested in the board of directors. (*Scott v. Los Angeles Mountain Park Co.*, 92 Cal. App. 258, 264 [267 P. 914].) Where a board of directors, in refusing to commence an action to redress an alleged wrong against a corporation, acts in good faith within the scope of its discretionary power and reasonably believes its refusal to commence the action is good business judgment in the best interests of the corporation a stockholder is not authorized to interfere with such discretion by commencing the action. (See *Bramhall v. Consumers Brick & Tile Co.*, 96 Cal. App. 540, 557 [274 P. 597].)"

and at pages 177-178 (Cal.) and 428 (Pac.):

> "Directors have the same discretion with respect to the prosecution of claims on behalf of the corporation as they have in other business matters. In this respect the fact that a claim may be founded in fraud does not differentiate it from other claims. Refusal to sue on a fraud claim is not, as plaintiffs contend, a ratification of fraud. The mere fact that a recovery for the corporation would probably result from litigation does not require that an action be commenced to enforce the claim. Even if it appeared to the directors of Douglas that at the end of protracted litigation substantial sums could be recovered from some or all of the

defendants, that fact alone would not have made it the duty of the directors to authorize the commencement of an action. It would have made it their duty to weigh the advantages of a probable recovery against the cost in money, time and disruption of the business of the company which litigation would entail. It appears from the nature of the litigation, the variety and complexity of the issues, the period of time during which the asserted frauds allegedly were committed, the multitude of transaction between the two corporations, the many individuals involved, and the questions of accounting, that the directors were confronted with litigation of formidable proportions. Many directors, other than those named as defendants herein, were also accused in general terms of conspiracy and fraud. A mistake of judgment on the part of a board of directors does not justify taking the control of corporate affairs from the board of directors and placing it with the stockholders. The board of directors may make incorrect decisions, as well as correct ones, so long as it is faithful to the corporation and uses its best business judgment.",

and at pages 178-179 (Cal.) and 431 (Pac.)

"There was no manifest breach of duty in its decision not to commence an action." The board exercised its business judgment. Under such circumstances, a stockholder may not usurp the discretionary powers of the managers of the corporation by commencing a derivative action. If, under such circumstances, the court should entertain such an action it would be substituting its own busi-

ness judgment for that of the directors. The determination of the matter by the board of directors is a bar to the action herein."

The California court, in *Levinson v. Cosmosart Realty & Bldg. Corp.* (1929), 96 Cal. App. 549 at 557, 274 Pac. 597 at 600, says:

"In the absence of fraud, breach of trust or transactions which are *ultra vires*, the conduct of directors in the management of the affairs of a corporation is not subject to attack by minority stockholders in a suit at equity, where such acts are discretionary and are performed in good faith, reasonably believing them to be for the best interest of the corporation. (14 Cor. Jur. 927, sec. 1444; 6 Fletcher, *supra*, p. 6924, sec. 4065, p. 6707, sec. 3902, p. 6951, sec. 4086; *Rogers v. Nashville etc. Ry. Co.*, 91 Fed. 299.)".

and at page 558 (Cal.) and 600 (Pac.) quoting from a New York case says:

"To warrant interference by a court in favor of minority stockholders . . . a case must be made out which plainly shows that such action is so far opposed to the true interests of the corporation itself as to lead to the clear inference that no one thus acting could have been influenced by any honest desire to secure such interest, but that he must have acted with an intent to subserve some outside purpose, regardless of the consequences to the company."

In Delaware Cases.

With respect to Delaware, this rule is well stated in *Davis v. Louisville Gas & Electric Co.* (1928), 16 Del.

Ch. 157; 142 Atl. 654; where the court says (142 Atl. 654 at pages 659-660):

"We have then a conflict in view between the responsible managers of a corporation and an overwhelming majority of its stockholders on the one hand and a dissenting minority on the other—a conflict touching matters of business policy, such as has occasioned innumerable applications to courts to intervene and determine which of the two conflicting views should prevail. The response which courts make to such applications is that it is not their function to resolve for corporations questions of policy and business management. The directors are chosen to pass upon such questions and their judgment unless shown to be tainted with fraud is accepted as final. The judgment of the directors of corporations enjoys the benefit of a presumption that it was formed in good faith and was designed to promote the best interests of the corporation they serve.

In *Bodell v. General Gas & Electric Corp.*, 15 Del. Ch. 420, 140 Atl. 264, the Supreme Court of this state said:

'If in the particular case there is nothing to show that the directors did not exercise their discretion for what they believed to be the best interest of the corporation, certainly an honest mistake of business judgment should not be reviewable by the court.'

The same principle was recognized by Delaware in *Hilo Chemical & Dye Corp. v. Steel & Tube Co. of America*, 14 Del. Ch. 1; 120 A. 480; *Id.*, 14 Del. Ch. 64; 122 A. 142; and expressly

stated in *Robinson v. Pittsburgh Oil Refining Co.*, 14 Del. Ch. 193; 126 A. 46.)

Apparently in challenge to these authorities, the Petition repeatedly cites *Pepper v. Litton*, 308 U. S. 295, and *Rogers v. Hill*, 289 U. S. 582 (Pet. pp. 4, 12, 16, 18, etc.) and the related case of *Rogers v. Guaranty Trust Co.*, 288 U. S. 123. These cases are not directly relevant except as they may discuss general principles of equity. They are federal cases and unless they purported to apply the law of either California or Delaware, could not be even indirectly applicable, and they do not so purport to apply the law of either of such states. They differ radically from the present situation on their facts and issues. *Pepper v. Litton* involved the powers of a bankruptcy court charged with protecting the interest of creditors, in determining priority and validity of claims for royalties and other payments made by the dominant figure of a one-man corporation which was part of a clear, though complicated, scheme to defraud the creditors. *Rogers v. Hill* presented primarily the question as to the validity of a by-law of the American Tobacco Company authorizing payment of percentages of the net profits of the company to certain officers as bonus payments, and the reasonableness of the payments made under that by-law in view of changed conditions. This was a case in the first instance of corporate power to adopt such a by-law under the laws of the state of incorporation, and subsequently whether the huge resulting bonuses could have any reasonable relationship to the value of services. The case was remanded to determine the latter issue. The related case of *Rogers v. Guaranty Trust Co.*, 288 U. S. 123, was an attack by a stockholder to

determine the validity of an issue of shares of the corporation to selected employees under the laws of the state of incorporation, *i.e.*, a question of corporate power in which the action brought in New York had been dismissed without prejudice as a discretionary matter on the ground that an action in the state of incorporation would be a more convenient forum. This Court affirmed the dismissal without prejudice by the trial court.

Pepper v. Litton seems primarily cited by Petitioner by way of argument that once a plaintiff challenges a director in a derivative suit, then the burden of proving the good faith of the transaction and its inherent fairness is on the director. The matter of burden of proof in a diversity case has been held by this Court to be governed by state law. (*Guaranty Trust Co. v. York*, 326 U. S. 99 at 109, 65 S. Ct. 1464; *City Service Oil Co. v. Dunlap*, 308 U. S. 208, 60 S. Ct. 201.) In the case at bar, evidence was adduced over two lengthy trials which did prove the good faith, the inherent fairness and the reasonableness of the contracts involved. The rule as to burden of proof in both California and Delaware is shown by the cases already cited, and they would control if they actually differ from *Pepper v. Litton*, but since the evidence *was* presented and could only come from the defendants, there is no issue of burden of proof here involved.

Petitioner, again with reference to *Pepper v. Litton*, cites (Pet. p. 4, Footnote 1) *Kemerson v. Burbank Amusement Co.*, 120 Cal. App. 2d 157, 260 P. 2d 823, to show that *Pepper* actually represents the law of California. The *Kemerson* case was an action against a corporation on an employment contract in

which the primary question was whether it was *ultra vires* the corporation for a Board of Directors to delegate substantially all its powers to an employee by contract. These cases do discuss general equitable principles involving the fiduciary status of directors of a corporation, but Petitioner's attempt to rely thereon is in total disregard of the facts as reflected in the Findings, and disregards the fact that such Findings justify the judgment under the much more pointed and parallel state authorities already cited.

In the case of *Alexander v. Tennessee Valley Authority*, 297 U.S. 288, 56 S. Ct. 466, this Court had before it a derivative suit which, however, did not depend upon diversity, and held that one reason why the plaintiff therein had a right to proceed was (297 U.S. 318) because he was not merely challenging the right of the Board of Directors to exercise its business judgment. This indicates the general federal acceptance of the so-called Business Judgment Rule, an acceptance of which is further reflected in the former Opinion of the Court in the present case when it said that a trial on the merits may show a dispute lying in the penumbra of business judgment unaffected by fraud. Fraud as so used in such Opinion, obviously means the presence of an improper influence or an imposition of a will antagonistic to the interest of the corporation itself which would prevent the exercise of that business judgment from being true, fair and independent.

This case, therefore, presents an instance where after two lengthy trials a court has found all the necessary elements which enter into the acceptance by a court of the business judgment of the corporation itself. All of the elements that determine that the business judg-

ment used herein was actually independent and proper have been found, and those elements are the elements which the courts of Delaware, of California and of the United States accept as determinative. It is submitted, therefore, as previously indicated, that Petitioner now seeks only a redetermination of whether the evidence supports those detailed and complete Findings.

Conclusion.

It is submitted that Petitioner has shown no reason whatever for the issuance by this Court of a Writ of Certiorari. There is no federal or constitutional question involved. There is no new question of general importance or interest or any conflict of authority. This Court, upon its former consideration, indicated that the trial which was ordered might show a case lying within the scope of the Business Judgment Rule, and the Findings of the trial court show that such a situation does exist, which Findings have been twice reviewed by the Court of Appeals and found to have adequate support in the record.

Respectively submitted,

RALPH E. LEWIS,

EUGENE D. WILLIAMS,

Attorneys for Respondents Jack L. Warner, Harry M. Warner, Hal B. Wallis, Henry Blanke and the Executors of the Estate of Harry M. Warner, Deceased.

FREEDMAN & FELIX,

H. R. KELLY,

Of Counsel.

XXV.

The Court finds with reference to each of said agreements described in paragraphs XXIII and XXIV hereof that the same was executed in the due course of the business of Warner Bros., was executed in each case on behalf of Warner Bros. by officers thereunto duly authorized; that said agreements, and each of them, were approved by the Board of Directors of Warner Bros., either at the time or by subsequent action; that the Board of Directors, which in each case approved each of such agreements, was free from control or domination by any of the individual defendants herein, or any alleged wrongdoer; that each of said agreements was duly considered in good faith by said Board of Directors and, in passing upon and approving or ratifying each of said agreements, the said Board of Directors and the members thereof, exercised its and their independent business judgment without fraud, coercion or domination.

That the contracts, amendments and agreements described in paragraphs XXIII and XXIV of these Findings, and each and all of them, were made and entered into in good faith and without fraud and were fair and reasonable; that said contracts, amendments and agreements, and each and all of them, were intended by the directors of Warner Bros. to be of financial benefit to said corporation and its stockholders; and said contracts, amendments and agreements, and each and all of them, were considered by the eleven members of the Board of Directors of Warner Bros. to be sound business arrangements for the best, present and

future interests of the Corporation that its approving and authorizing said contracts, amendments and agreements, and each and all of them, the officers and Board of Directors acted in good faith and exercised their independent business judgment. That neither the stockholders nor officers or directors of Warner Bros. were, at any time involved in this action, antagonistic to the interests of the Corporation.

XXVI.

The Court further finds that during the trial of this action the plaintiff has raised issues not presented by the pleadings having to do with matters of interpretation of the agreements herein involved and accounting practices with relation thereto which involve essentially the following matters:

(a) Claim that the method of the recoupment of the loss sustained by the parties hereto in connection with the picture "My Girl Friday" was erroneous and that the interpretation of the contract under which said recoupment was made was also erroneous;

(b) That by reason of delays in production of pictures the defendant Sperling received salary over a longer period of time than he should have and in consequence Warner Bros. was required to bear a larger amount of such salary than was contemplated by the parties;

(c) That the charging of the loss on the abandoned literary properties to overhead allocable to pictures produced was erroneous; and

(d) That miscellaneous items of United overhead consisting principally of sums paid as attorneys' fees

and to certain employees of United, were improperly allocated to overhead instead of to direct cost of pictures and that thereby Warner Bros. was deprived of payment of its overhead upon such items.

XXVII.

The Court finds that during the course of the trial, at the suggestion of the Court, the plaintiff elected to present and did present the claims asserted by the Complaint herein, and, in addition thereto, each of the matters referred to in the immediately preceding paragraph of these Findings, in writing, to the Board of Directors of Warner Bros. for its action with reference thereto; that said Board of Directors duly considered each of the claims asserted by the plaintiff herein, had an independent investigation made thereof, received a report of such investigation, duly considered and discussed each of such claims and said report and, thereafter, on motion duly made and seconded, said Board unanimously adopted the following resolution:

"Resolved: That due consideration having been given to the letter of October 10, 1958, referring to the lawsuit entitled Smith v. Sperling, et al., signed by counsel for the plaintiff, the letter of October 29, 1958, signed by counsel for Warner Bros. Pictures, Inc., Harry M. Warner and Jack L. Warner, defendants in the lawsuit, and the report of November 21, 1958, signed by Messrs. Donovan, Leisure, Newton & Irvine, counsel retained by the Board to investigate the law and facts and report with their recommendations

"It is the considered judgment of this Board, in view of all the circumstances, that

(1) it is not in the best interests of the Corporation to lend its sanction to proceedings in the pending

action entitled Smith vs. Sperling, et al., seeking cancellation of the agreement of September 28, 1945, with United States Pictures, Inc.; and

(2) it is not in the best interests of the Corporation to lend its sanction to any proceedings against the Estate of Harry M. Warner, Jack L. Warner, Milton Sperling or United States Pictures, Inc., in the pending action entitled Smith vs. Sperling, et al., either as included in the present complaint or in said complaint if amended to include any of the matters set forth in the letter of October 10, 1958; and

(3) it is not in the best interests of the Corporation to institute any legal proceedings against the Estate of Harry M. Warner, Jack L. Warner, Milton Sperling or United States Pictures, Inc., with respect to the matters set forth in the letter of October 10, 1958;

"Further Resolved: That the Secretary be instructed to reply to the letter of October 10, 1958, by sending to the writer a copy of that portion of the minutes of the meeting of October 24, 1958, and of this meeting, which relate to said letter, together with a copy of the report of November 21, 1958, of Messrs. Donovan, Leisure, Newton & Irvine."

The Court finds that at the time of the adoption of said resolution the Board of Directors of Warner Bros. consisted of nine members, of whom eight were present; that seven only, of said members considered the matters referred to by the plaintiff herein and the report of the Board's investigation thereon and voted thereon. That the members of said Board of Directors who voted were Charles Allen, J. L. Wobbill Catchings, Stanleigh P. Friedman, Benj. Kalmenson, W. J. Mur-

R. W. Perkins and Serge Semenenko. That the defendant, Jack L. Warner, a member of said Board, was not present at said meeting; that his brother Albert was present but did not participate in the discussion or vote with reference to such matters.

The Court finds that the said Board of Directors acted in good faith, without fraud, coercion or domination of any person or persons whatsoever; that in considering and passing upon said matters said Board and the members thereof intended to and did act in the interest of Warner Bros. and exercised its and their independent business judgment; and that its and their decision, as above set forth, was the exercise by it and them of such independent business judgment; that such matters were matters properly before said Board and properly the subject of the exercise by it of its said independent business judgment.

COPY

IN THE

Supreme Court of the United States

October Term, 1960

No. 245

CHARLES B. SMITH, as Special Administrator of the Estate of Edward S. Birn, Deceased,

Petitioner,

vs.

MILTON SPERLING, JACK L. WARNER, UNITED STATES PICTURES, INC., WARNER BROS. PICTURES, INC., and HERBERT FRESTON, MILTON SPERLING, REA E. WARNER and DORIS WARNER VIDOR AS EXECUTORS OF THE ESTATE OF HARRY M. WARNER, DECEASED,

Respondents.

PETITIONER'S REPLY.

HERMAN H. LEVY,
756 South Broadway,
Los Angeles 14, California,
GEO. C. LYON,
MOSS, LYON & DUNN,
210 West Seventh Street,
Los Angeles 14, California,
Attorneys for Petitioner.

Parker & Son, Inc., Law Printers, Los Angeles. Phone MA 6-9171.

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Respondents.

PETITIONER'S REPLY.

The opposing arguments illustrate and deepen the sorry spectacle of how rocky the road can be made for the American shareholder who dares to venture to expose corporate machination, even in a transparently controlled corporation; in a day and age in which "effective working control" of publicly-owned companies has come to be traded in as a virtual commodity—bought and sold as such daily.

For nearly 10 years (1948-1958) spurious protests by the Warners that the corporation was *not controlled by them* provided an insurmountable obstacle (the first of two such obstacles) in petitioner's path to obtaining a day in court on the merits—something that he still has not had.

By the time the case came on for trial after remand—this is not gainsaid by the respondents—a number of amendments, reamendments and supplements to the Warner-United contracts had been made, *all of which* [illegible] that had poured millions of *Warner* money into financing "independent" production by United and into the cost of distributing by Warner a series of motion pictures, in the course of which large payments of *Warner* money were made to United and by United to Sperling.

Nor do respondents gainsay—indeed they concede, as they must, that at the 1958 hearing petitioner claimed

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[illegible] were not shown to control the corporation [illegible] 751. That ruling became the focal point of the controversy thereafter [illegible] problem that was not settled until 1958 when this Court reversed the lower courts and remanded the case for a hearing on the merits.

not only had these expiring Warner-United contracts and the amendments unwarrantedly favored the president's son-in-law, but, throughout the 10-year period that it took to settle the jurisdictional problem, *these contracts had been unfairly maladministered*, and that *at issue* were a series of *specifically identified* Warner-United-Sperling transactions under these expiring contracts which transactions, though challenged by petitioner that they resulted in more than a million dollars of colorable, purposefully contrived, illegal, *ultra vires* bonus payments[2] to the president's son-in-law, these huge payments to United and to Sperling were *refused scrutiny* and *excluded from consideration* by the District Judge.

Exposure by petitioner at the 1958 hearing of how bogus had been the Warners' protests about *no control* was followed by their protest that "effective working control" still does not evidence "domination" by them of the Board which handed down a "Business Judgment" against lending directorial "sanction" to a *judicial* determination from evidence painstakingly assembled and *offered for the record* whether the Warner son-in-law was or was not made the beneficiary of an *illegal* million-dollar windfall.

This second obstacle to the proof of "domination" by the interested industries has been equally efficacious in blocking and barring a decision on the merits.

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[2] [illegible]

We urge on behalf of the petitioner, that to so focus the "Business Judgment Rule" is to make it spectacularly repugnant to equity: The rule looms up as a royal road to the dispensing of prequisites with impunity; a refuge—a haven for influential possessors of and traders in corporate control of publicly-owned companies who, operating behind respectable "fronts"[3] are rendered virtually immune against successful attack although they siphon off and give away millions of confiding stockholders' money[4] to strategically-placed relatives.

We submit that respondents' intimations to the effect that the state courts' view of the problem presented does not square with the federal view, are not borne out by the authorities cited.

Respectfully submitted,

HERMAN H. LEVY,
GEO. C. LYON,
MOSS, LYON & DUNN,
Attorneys for Petitioner.

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[3] Dunlay, Directors Who Do Not Direct, 47 Harv. Law Rev. 1305.

[4] As recently as two weeks ago, the nationally syndicated [illegible] reported on an SEC report that an extensive [illegible] on the N. Y. Stock Exchange to ascertain [illegible] stocks bought by individuals [illegible] investment they [illegible] [illegible] This segment of [illegible] is particularly [illegible] [illegible] are becoming [illegible] Times, Los Angeles Mirror, Aug. 1, 1958.